Supreme Court, U.S.
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No. __-____

IN THE
Supreme Court of the United States

ENRON POWER MARKETING, INC.,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

PETITION FOR A WRIT OF CERTIORARI

JEFFREY D. WATKISS
BRACEWELL & PATTERSON, L.L.P.
2000 K Street, N.W.
Suite 500
Washington, D.C. 20006
(202) 828-5800

LOUIS R. COHEN
Counsel of Record
JOSEPH E. KILLORY, JR.
IJAY PALANSKY
MICHAEL PLOTNICK
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, D.C. 20037-1420
(202) 663-6000

Counsel for Petitioner Enron Power Marketing, Inc.

30pp

QUESTIONS PRESENTED

Whether the Federal Energy Regulatory Commission (FERC) has jurisdiction under the Federal Power Act (FPA), 16 U.S.C. §§ 792 *et seq.*, to regulate all transmission of electric energy in interstate commerce, including interstate transmission of electric energy that is sold to retail customers at a "bundled" price.

Whether FERC had jurisdiction and the obligation under the FPA to eliminate pervasive "undue discrimination" in the provision of interstate electric energy transmission services by requiring transmission-owning utilities to provide interstate transmission services on the same terms to all users, for all interstate transmissions, including transmissions bundled with retail sales.

Whether the court of appeals erred in ruling that FERC had discretion to interpret the FPA as denying FERC the necessary jurisdiction to remedy the undue discrimination it had found in the provision of interstate transmission.

PARTIES TO THE PROCEEDING

The list of parties before the court of appeals is set forth at Petitioner's Appendix 683a to 688a.

RULE 29.6 STATEMENT

Enron Corp. is the only publicly held company owning 10% or more of the petitioner's stock. The following companies are the parent companies of petitioner:

Enron Corp.

Enron North America Corp.

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PETITION FOR A WRIT OF CERTIORARI

Enron Power Marketing, Inc. (Enron) respectfully petitions for a writ of certiorari to review the decision of the United States Court of Appeals for the District of Columbia Circuit in this case. A prior petition by other parties (No. 00-568) was docketed on October 13, 2000. In broad terms, the petition in No. 00-568 contends that FERC Order No. 888 and related orders exceeded FERC's jurisdiction. The present petition contends that, on the contrary, FERC understated its jurisdiction and hence failed to respond to a serious nationwide problem it had found and was obligated to cure. The present petition is timely filed under this Court's Rule 13.1 and is not a conditional cross-petition under Rule 12.5.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the District of Columbia Circuit is reported at 225 F.3d 667 (D.C. Cir. 2000), and reprinted at Petitioner's Appendix (Pet. App.) 3a to 121a. Federal Energy Regulatory Commission Order No. 888 is reported at F.E.R.C. Stats. & Regs. ¶31,036, 61 Fed. Reg. 21,540 (1996). Its rehearing decisions, Order No. 888-A and Order No. 888-B, are reported respectively at III F.E.R.C. Stats. & Regs. ¶31,048, 62 Fed. Reg. 12,274 (1997), and 81 F.E.R.C. ¶61,248, 62 Fed. Reg. 64,688 (1997). Relevant portions of FERC Orders Nos. 888 and 888-A and FERC's Notice of Proposed Rulemaking, F.E.R.C. Stats. & Regs. ¶32,514, 60 Fed. Reg. 17,662 (1995), are reprinted at Pet. App. 125a to 654a.

JURISDICTION

The court of appeals entered its judgment on June 30, 2000, and issued its order denying a timely-filed motion for rehearing on August 22, 2000. This petition is timely filed pursuant to 28 U.S.C. § 2101(c) and S. Ct. R. 13. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTES AND RULES INVOLVED

Sections 201, 205, 206, 211, 212, 213, and 313 of the Federal Power Act (FPA), 16 U.S.C. §§ 824, 824d, 824e, 824j, 824k, 8241 and 8251, are reprinted in the Appendix at Pet. App. 652a to 681a.

Sections 1, 4, and 5 of the Natural Gas Act (NGA), 15 U.S.C. §§ 717, 717c, and 717d, are reprinted in the Appendix at Pet. App. 645a to 651a.

Relevant portions of FERC Orders Nos. 888 and 888-A are reprinted in the Appendix at Pet. App. 125a to 551a.

STATEMENT

A half century ago, electricity was provided to almost all users by regulated-monopoly local electric utilities that performed all three functions (electric energy generation, transmission, and distribution) and sold electricity to each user for a single "bundled" charge. Today, electric energy is generated and marketed by a multitude of competing firms (including the traditional utilities competing in other markets), and it is carried to customers over transmission facilities connected into the interstate grid. Important segments of the grid, however, continue to be owned by the monopoly local utilities.

The central issue in this case is the authority and obligation of FERC to prevent the utilities that own these segments of the interstate grid from discriminating in favor of their own service to their own customers and against competing suppliers of electric energy. FERC found that transmission-owning utilities have an inherent incentive to discriminate, and have discriminated, against competing suppliers that are dependent on the utilities for transmission services. Pet. App. 214a-216a, 315a-331a. To remedy this (in part), FERC required each such utility to adopt a pro forma "open access transmission tariff" (OATT) and to take transmission services for its own *wholesale* sales under the OATT pursuant to the same terms and conditions it offers to other users. Pet. App. 178a. FERC applied this same requirement to *un*bundled retail sales, i.e., retail transactions in which the utility, either on its own or at the behest of state regulators, states separate charges for the electric energy and for the service of transmitting the energy. Pet. App. 306a. But FERC declined to apply this requirement to a utility's transmission services for which the charge is "bundled" by the utility into its retail charge for electricity. FERC at first stated that it was not "necessary" (although it would be "helpful") to impose the OATT on the transmission component of bundled retail sales, Pet. App. 234a, but FERC

ultimately relied solely on an asserted lack of jurisdiction. *See* Pet. App. 454a-456a.

The court of appeals upheld FERC's exercise of jurisdiction over interstate transmission for wholesale and unbundled retail sales, and upheld FERC's discretion to determine that it lacked jurisdiction over interstate transmission for bundled retail sales. The result is an interpretation of the statute that is contrary to its plain language and to the established interpretation of the parallel provision of the Natural Gas Act, 15 U.S.C. § 717, and that leaves transmission owners free to continue the discrimination FERC found with respect to most of the electric energy they carry.

A. Petitioner

Petitioner Enron is one of North America's largest marketers of electric energy, selling to both wholesale and retail customers. To transmit the electric energy it sells, Enron buys transmission services over systems owned by other firms, including local-monopoly utilities. Enron depends on access to these systems on nondiscriminatory terms (which include both price and conditions of service) to be able to compete in the sale of electric energy. Some of Enron's sales activity is in direct competition with the sales operations of the transmission-owning utilities on whose systems Enron must depend.

B. Statutory Background

The FPA gives FERC jurisdiction over "the transmission of electric energy in interstate commerce" and "all facilities for such transmission." FPA § 201(b), 16 U.S.C. § 824(b). It also gives FERC jurisdiction over "the sale of electric energy at wholesale in interstate commerce." *Id.* These are two distinct grants of jurisdiction. Unlike its jurisdiction over the sale of electricity, FERC's jurisdiction over interstate "transmission" is not limited by the words "at wholesale." *See* Pet. App. 338a ("statute . . . makes no

distinction between wholesale transmission and retail transmission"); *FPC v. Louisiana Power & Light Co.*, 406 U.S. 621, 636 (1972) (interpreting the parallel provisions of the NGA, 15 U.S.C. §§ 717 *et seq.*).[1]

Section 205(b) of the FPA, 16 U.S.C. § 824d(b), bars any public utility, "with respect to any transmission or sale subject to the jurisdiction of the Commission," from "grant[ing] any undue preference or advantage to any person or subject[ing] any person to any undue prejudice or disadvantage" and requires each utility to file tariffs setting forth its "practices." Section 206(a), 16 U.S.C. § 824e(a), commands that if FERC determines that a practice is "unjust, unreasonable, unduly discriminatory or preferential," FERC must cure the discrimination and "determine the just and reasonable . . . practice . . . to be thereafter observed and in force, and shall fix the same by order."

C. Regulatory Background

The FERC orders at issue respond to two fundamental changes in the marketing of electricity over the last several decades. First, with strong congressional encouragement, independent generators and marketers of electric power have emerged to compete with each other and with the local utilities that traditionally supplied electricity on a local-monopoly basis. Second, it has become physically possible to transmit electric power over longer distances without excessive losses, and transmission facilities have been interconnected into a large interstate grid. Hence where both the generation and delivery of electric power were once largely local, and prices for electricity were once determined

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[1] All of the provisions of Part II of the FPA pertinent to this case are "in all material respects substantially identical" to parallel provisions of the NGA. *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981) (quotation omitted). This Court has an "established practice of citing interchangeably decisions interpreting the pertinent sections of the two statutes." *Id.*

primarily by state regulation based on each utility's costs,[2] generation and marketing are now subject to intense interstate competition.

Congress began to encourage the construction of competitive electric generation facilities in 1978 in response to the energy crisis of the 1970s. The Public Utility Regulatory Policies Act of 1978, 16 U.S.C. §§ 2601 *et seq.* (PURPA), provided an incentive for such construction by requiring traditional utilities to buy power from competitive facilities under specified conditions. *See* 16 U.S.C. §§ 2601, 2611; Pet. App. 147a-148a. This modest step launched a transformation of the industry such that "[i]n 1992, for the first time, generating capacity added by independent producers exceeded capacity added by utilities." Pet. App. 151a (citation omitted).

New, competitive generation facilities, however, faced a big roadblock. "[T]hese entities needed transmission service in order to compete in electricity markets." Pet. App. 150a. In order for there to be competitive power markets, "all wholesale buyers . . . must have equal access to the transmission grid." Pet. App. 558a. Congress took aim at this roadblock by enacting the Energy Policy Act of 1992 (EPAct), 42 U.S.C. § 6807a, which gave FERC greater authority to order transmission-owning utilities to serve competing marketers. *See* Pet. App. 154a.

Three years later, in response to complaints about the halting, case-by-case implementation of third-party transmission rights under EPAct, FERC promulgated Order

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[2] Under the historical model, in which a stand-alone monopoly utility performed or contracted for generation, transmission, and delivery and billed for all of those services with a single, bundled charge, power typically was generated close to the user. This pattern of self-sufficient regional or local utilities, each located near a captive customer base, was encouraged by the then existing regulatory scheme. For a rate-of-return-regulated local monopoly, the availability of lower-cost electricity from other regions was of little or no consequence. *See* Pet. App. 141a-145a.

No. 888. Pet. App. 157a-159a; 382a ("Utility practices that were acceptable in past years, if permitted to continue, will smother the fledgling competition in electricity markets and undermine the national policies reflected in the Energy Policy Act of 1992 to encourage the development of competitive markets."). In Order No. 888, FERC found pervasive undue discrimination by owners of transmission facilities—and found that it had a duty to eliminate this discrimination. "The inherent characteristics of monopolists make it inevitable that [owners] will act in their own self-interest to the detriment of others by . . . providing inferior transmission to competitors . . . to favor their own generation, and it is our duty to eradicate unduly discriminatory practices." Pet. App. 214a. FERC also found "more than sufficient reason to believe that transmission monopolists currently engage in unduly discriminatory practices, and that they will continue to engage in unduly discriminatory practices, unless we fashion a remedy to eliminate their ability and incentive to do so." Pet. App. 216a-217a.

The remedy FERC fashioned was "functional unbundling." Specifically, FERC required every public utility to (i) purchase transmission "for all its new *wholesale sales and purchases* of energy under the same tariff of general applicability as do others" and (ii) "state separate rates for *wholesale* generation, transmission, and ancillary services." Pet. App. 178a (emphasis added).[3] FERC applied the same requirements to transmissions for unbundled retail sales, i.e., sales in which transmission and power charges are stated separately, either on the utility's own initiative or at the behest of a state regulatory commission. Pet. App. 306a.

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[3] Although FERC initially stated that its rule would apply to both wholesale purchases and wholesale sales, *id.*, it later dropped the reference to wholesale purchases, requiring a utility not to discriminate with respect to transmission only when it is *selling* power at wholesale. Pet. App. 451a-453a.

FERC declined, however, to extend its functional unbundling remedy to transmission for bundled retail sales. FERC recognized that failure to require utilities to take transmission for their retail sales under the same tariff "raises the possibility that . . . transmission service for retail purposes will be superior" to wholesale. Pet. App. 634a. But FERC said, initially, "[W]e do not believe [functional unbundling as to bundled retail sales] is necessary. In addition, it raises numerous difficult jurisdictional issues . . . ." Pet. App. 235a. On rehearing, however, FERC dropped the argument that retail unbundling was "unnecessary" and decided, instead, that the "jurisdictional issues" were an absolute bar to regulation of the interstate transmission for bundled retail sales. Pet. App. 395a; 405a-410a.

D. Proceedings Below

On petitions for review, the D.C. Circuit upheld FERC's orders against challenges both that they exceeded FERC's jurisdiction and that they did not go far enough to carry out FERC's statutory obligations to remedy undue discrimination. *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 681, 687 (D.C. Cir. 2000), Pet. App. 8a-9a. 20a-21a. The State of New York and other parties contended that FERC has no jurisdiction over interstate transmission for any retail sales, even unbundled sales; the D.C. Circuit rejected this contention, holding that the Act confers jurisdiction over unbundled interstate transmission of electric energy whether it is then sold at wholesale or retail. Pet. App. 34a-35a. Other parties challenged FERC's authority to remedy the undue discrimination it had found by requiring transmission-owning utilities to grant open access to the interstate transmission grid, arguing in part that the FPA did not confer such jurisdiction on FERC; the D.C. Circuit also rejected this argument, finding that FERC had "authority under FPA §§ 205 and 206 to require open access

as a generic remedy to prevent undue discrimination." Pet. App. 21a.

Conversely, Enron and other parties challenged FERC's failure to provide a complete or adequate remedy for the undue discrimination FERC had found. Enron noted that most electric energy carried over local utilities' transmission facilities is carried for bundled retail sales, and Enron argued that FERC's failure to subject such transmission to the OATT would allow local utility monopolies to continue to discriminate in favor of their own retail customers. Citing *FPC v. Louisiana Power & Light Co.*, 406 U.S. 621 (1972), Enron argued that FERC has statutory jurisdiction to regulate *all* interstate transmission of electric energy, regardless of whether that energy is then sold at wholesale or retail, unbundled or bundled. Relying on the plain language of the FPA, Enron further argued that FERC was required to remedy any undue discrimination it found in electric power transmissions over which it had jurisdiction. *See*16 U.S.C. §§ 824d, 824e. FERC acknowledged its obligation to remedy such undue discrimination, but defended its failure to do so on the basis that the FPA does not give it authority to regulate the interstate transmission component of bundled retail sales.[4]

The D.C. Circuit determined that it was appropriate to defer to FERC's statutory interpretation. The court did not

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[4] In Order No. 888, FERC determined that, although its jurisdiction over interstate transmission was unqualified, it nevertheless was "not necessary" for it to apply its nondiscrimination rules directly to transmission of electric energy for retail sales. Pet. App. 235a-236a. On rehearing, in Order No. 888-A, FERC explained that its historical practice of not regulating transmission for bundled retail sales was "not the result of a legal requirement; [but rather] the practical result of the way electricity has historically been bought and sold." Pet. App. 476a. Elsewhere in Order No. 888-A, however, FERC stated (inconsistently) that it does not have jurisdiction over transmission bundled with retail sales. Pet. App. 455a. The court of appeals upheld FERC on the ground that it had discretion to reach the latter conclusion. Pet. App. 35a.

itself reject Enron's argument that the Act gives FERC jurisdiction over transmission for bundled retail sales. On the contrary, the Court noted that a permissible reading of the statute included "constru[ing] transmissions bundled with generation and delivery services and sold to a consumer for a single charge as . . . transmission services in interstate commerce" within FERC's jurisdiction. Pet. App. 35a. The court also noted Enron's reliance on *Louisiana Power & Light* and other precedent holding that FERC's jurisdiction over interstate transmission of natural gas does not depend on whether the gas is sold at wholesale or retail, bundled or unbundled. Pet. App. 30a-35a. Without attempting to distinguish those cases, the court ruled that the decision to decline jurisdiction over interstate transmission of electric energy for bundled retail sales was "a permissible policy choice" as to which FERC was entitled deference under *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984). Pet. App. 35a.

REASONS FOR GRANTING THE PETITION

Electricity is in many ways the nation's most important product. The availability and price of electricity directly affect the cost and conditions of production of almost every other product. Hence, very few legal questions are of more practical significance than the question presented by this petition: whether FERC has the authority, and whether it has the obligation, to protect competing purchasers of interstate electric transmission services against discrimination by the owners of transmission facilities in favor of their own use of the transmission grid to access their retail customers.

The D.C. Circuit erred in answering that question. The FPA, by its plain language, gives FERC jurisdiction over all interstate transmission of electric energy, regardless of the terms of sale of the energy that has been transmitted, and obliges FERC to remedy all undue discrimination in services within its jurisdiction. FERC had no discretion to interpret

away this authority and obligation. Indeed, this Court and the courts of appeals have squarely upheld the same power and obligation under the parallel provision of the Natural Gas Act in cases indistinguishable from the present case except that natural gas rather than electricity was involved. If FERC lacks jurisdiction to remedy undue discrimination in the interstate transmission of electric energy, then no agency, state or federal, has authority to do so.

I. THE D.C. CIRCUIT ERRED IN DEFERRING TO FERC'S INCORRECT INTERPRETATION OF A CENTRAL PROVISION OF THE FPA.

The FPA "'fairly bristles' with concern for undue discrimination" in the interstate transmission and sale of energy. Pet. App. 181a-182a (quoting *Associated Gas Distribs. v. FERC*, 824 F.2d 981, 998 (D.C. Cir. 1987)). In particular, § 206 commands FERC to remedy "any [unduly discriminatory] rate, charge, or classification . . . [imposed by] any public utility for any transmission or sale subject to the jurisdiction of the Commission." 16 U.S.C. § 824e(a).

The remedial measures required by Order Nos. 888 and 888-A were taken pursuant to FERC's § 206 obligation to eliminate undue discrimination. FERC found "systemic anticompetitive behavior" by "monopolist" owners of transmission facilities. Pet. App. 21a; 131a-136a; 608a-621a; 16 U.S.C. § 824e. FERC explained that because of the recent increase in competition among electric power generators, the "economic self-interest of transmission monopolists" had resulted in widespread discrimination in access to and terms of interstate transmission. Pet. App. 213a-214a. FERC identified such discrimination as the single greatest impediment to competitive power markets. Pet. App. 558a. FERC concluded that in order to satisfy its mandate under § 206 it would have to "eliminate the . . . ability and incentive" of transmission monopolists to

handicap competitors by discriminating in favor of their own generation and sales. Pet. App. 216a-217a.

The remedy FERC selected to accomplish this was "functional unbundling," which required every public utility to: (i) purchase transmission under the same tariff of general applicability as other users of the same transmission services; (ii) "state separate rates for wholesale generation, transmission, and ancillary services"; and (iii) "rely on the same electronic information network [as] its transmission customers . . . to obtain information about its transmission system when buying or selling power." Pet. App. 178a.

But FERC failed to apply this remedy to the majority of interstate transmission. FERC found that it would be "helpful" in eliminating discrimination to extend functional unbundling to the transmission component of bundled retail sales. Pet. App. 235a. Indeed, FERC noted that failure to extend its rules to such transmission would allow important discrimination to continue. Pet. App. 634a. Nevertheless, FERC declined to extend its rules to transmissions for bundled retail sales, asserting that it lacked jurisdiction to do so. *See* Pet. App. 395a, 451a. As the D.C. Circuit described FERC's explanation, FERC reasoned that "once the transmission service is bundled with generation and local distribution, it becomes merely a component of the retail sale itself, over which FERC has no jurisdiction." Pet. App. 31a.

The D.C. Circuit was not itself persuaded by this explanation, but it ruled that FERC's interpretation was entitled to deference under *Chevron*. That ruling was wrong for two reasons. First, the statute itself is clear, and when Congress has spoken directly to the point at issue there is no leeway for contrary agency interpretation. *Chevron*, 467 U.S. at 842-43; *see also Nat'l Credit Union Admin. v. First Nat'l Bank & Trust Co.*, 522 U.S. 479, 499-503 (1998). Second, this Court has interpreted the parallel provision of the NGA in a manner that precludes FERC's interpretation of its FPA jurisdiction.

1. *The statutory language is controlling.* The FPA gives FERC explicit and unqualified jurisdiction over all interstate transmissions of electric energy, whether the electric energy is then sold at wholesale or retail, unbundled or bundled. Indeed, FERC itself and the D.C. Circuit have so recognized. Section 201(b) states, in separate phrases, that FERC has jurisdiction over (a) "the transmission of electric energy in interstate commerce," and (b) "the sale of electric energy at wholesale in interstate commerce." 16 U.S.C. § 824(b). As FERC has noted, its jurisdiction over interstate transmission is not limited by the words "at wholesale": "Unlike our jurisdiction over sales of electric energy, which section 201 specifically limits to sales at wholesale, the statute does not limit our transmission jurisdiction over public utilities to wholesale transmission. . . ." Pet. App. 305a, *accord* Pet. App. 338a-339a. "[S]ection 201 of the FPA, *on its face*, gives the Commission jurisdiction over transmission in interstate commerce . . . without qualification." Pet. App. 305a. The D.C. Circuit agreed that "[b]oth FPA § 201(a) and (b) clearly and unambiguously confer upon FERC jurisdiction over the 'transmission of electric energy in interstate commerce.'" Pet. App. 32a. The legislative history makes it clear that this was deliberate: "Jurisdiction is asserted . . . over all interstate transmission lines whether or not there is sale of the energy carried by those lines . . . ." S. Rep. No. 74-621, at 48 (1935) (*quoted in* Order-888, Pet. App. 343a).[5]

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[5] There is no doubt that the transmissions at issue in this case, like virtually all transmissions of electric energy today, are "in interstate commerce." As the D.C. Circuit explained, as long as such transmissions flow on interstate grids, they are in interstate commerce because, "where the transmission lines of two utilities interconnect, their energy commingles, such that inevitably some energy [is] transmitted . . . across state lines." Pet. App. 34a. *See also FPC v. Florida Power & Light Co.*, 404 U.S. 453, 463 (1972); *FPC v. S. Cal. Edison Co.*, 376 U.S. 205, 215-16 (1964).

Despite the clarity of the statute, the D.C. Circuit found an ambiguity which it explained as follows:

> A regulator could reasonably construe transmissions bundled with generation and delivery services and sold to a consumer for a single charge as *either* transmission services in interstate commerce *or* as an integral component of a retail sale. . . . FERC's decision to characterize bundled transmissions as part of retail sales subject to state jurisdiction therefore represents a statutorily permissible policy choice to which we must defer under *Chevron*.

Pet. App. 35a. (emphasis added). But the choice is not "either/or." The transmissions at issue are *both* interstate transmissions of electric power *and* (if the utility elects to set a single bundled charge) components of bundled retail sales. Transmission in interstate commerce does not cease to be an interstate transmission because of the manner in which the electricity is then sold. The bundling of that transmission with the sale of energy for billing purposes does not mean that an interstate transmission has not occurred. FERC's interpretation contradicts the clear language of § 201(b), and the D.C. Circuit should not have deferred to it.

2. *This Court's interpretation of the parallel provision of the NGA precludes the interpretation FERC adopted in this case. Chevron* does not command or authorize deference to an agency interpretation of a statute that is directly contrary to the interpretation of the same provision by an earlier decision of this Court. *See Natural Res. Def. Council v. Nuclear Regulatory Comm'n*, 216 F.3d 1180, 1189 (D.C. Cir. 2000) ("[c]arefully considered language of the Supreme Court . . . generally must be treated as authoritative" (internal citation omitted)). That is exactly the situation here, except that the earlier decision interpreted the parallel provision of the NGA.

In *FPC v. Louisiana Power & Light Co.*, 406 U.S. 621, 636 (1972) (*LP&L*), this Court squarely held that NGA § 1(b) gave FERC's predecessor, the Federal Power Commission (FPC), jurisdiction over interstate transportation of natural gas for "direct" (i.e., bundled) retail sale. In relevant part, NGA § 1(b) is identical to FPA § 201(b): "The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce." 15 U.S.C. § 717(b). Nevertheless, LP&L argued that the FPC lacked jurisdiction to regulate the transportation component of direct retail sales of natural gas. This Court disagreed. The Court distinguished the FPC's jurisdiction over transportation of natural gas from its jurisdiction over gas sales, explaining: "Each of these is an independent grant of jurisdiction and, though the Act's application to 'sales' is limited to sales of interstate gas for resale, the Act applies to interstate 'transportation' regardless of whether the gas transported is ultimately sold retail or wholesale." 406 U.S. at 636.[6]

This Court's determination in *LP&L* that FERC has jurisdiction over the transportation component of "direct" sales of natural gas is an authoritative precedent for construing the parallel provision of the Federal Power Act; FERC had no discretion to interpret FPA § 201(b) in a contrary manner, and it was error for the D.C. Circuit to defer to discretion that FERC did not have.

Ironically, the D.C. Circuit itself explained in an earlier case why the FERC interpretation, rejected under the NGA in *LP&L* and reasserted under the FPA in the present case, is necessarily wrong. In *Mississippi River Transmission Corp. v. FERC*, 969 F.2d 1215 (D.C. Cir. 1992) (*MRT*), the court ruled that FERC had jurisdiction to regulate a natural gas transportation rate "imbedded in" a bundled retail sale. *MRT*,

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[6] Similarly, the Fifth Circuit held in *Fort Pierce Util. Auth. v. FPC*, 526 F.2d 993 (5th Cir. 1976) that "[t]he Commission has an independent grant of jurisdiction that applies to 'the transportation of natural gas in interstate commerce.'" *Id.* at 997 (quoting *LP&L* at 636).

969 F.2d at 1219 n.4. The court said, "FERC is not barred from regulating a pipeline's interstate transportation of natural gas merely because the sale of the gas being transported is not itself subject to federal regulation. FERC's authority over such transactions is beyond dispute." *Id.* at 1217 (citing *FPC v. E. Ohio Gas Co.*, 338 U.S. 464, 468 (1950)). The court explained that any other rule would invite manipulation by the utility, which would be able to choose its regulator simply by offering bundled or unbundled pricing of the same product and service:

> As far as the statute is concerned, there would have been no doubt of FERC's section 1(b) authority if MRT, instead of charging a bundled price, had charged separately for transporting the gas and for the gas itself. To accept MRT's position would therefore be tantamount to conferring on private parties the power to decide whether FERC could set the rate for interstate transportation. Private parties would have this power because it would be entirely up to them whether to structure a direct sale and interstate-transportation transaction in terms of a bundled price or separate charges.

Id. at 1218. Similarly here, FERC's interpretation of FPA § 201(b) would make its jurisdiction over interstate transportation entirely contingent on whether the utility, which provides its retail customers with both electric energy and transmission services, selects bundled or unbundled pricing (on its own or at the behest of local regulators), an accounting matter that should be irrelevant to the FPA's grant of jurisdiction over interstate transmissions.

II. WHETHER FERC HAS JURISDICTION TO PREVENT DISCRIMINATION BY OWNERS OF INTERSTATE TRANSMISSION FACILITIES IS AN IMPORTANT QUESTION MERITING THIS COURT'S REVIEW.

The D.C. Circuit's decision that FERC lacks jurisdiction under the FPA to bar transmission owners from discriminating in favor of their own bundled retail sales presents a legal question of the greatest practical importance. The price and reliability of electricity in each locality in the Nation are obviously important to the consumers and businesses in that locality and to the economy of the Nation as a whole. To achieve low prices and high reliability, Congress has encouraged competition in the generation and interstate marketing of electric energy. Effective competition depends—as FERC repeatedly has found—on non-discriminatory access to transmission facilities, which are often owned by traditional regulated-monopoly utilities that have a strong incentive to discriminate in favor of their own services to their own retail customers. Only FERC has the authority to bar this discrimination, by requiring each transmission-owning utility to take interstate transmission service for itself on the same terms as it offers to other users of its facilities. FERC's decision to decline that jurisdiction with respect to the majority of interstate transmissions leaves exactly the kind of regulatory gap the FPA was intended to fill.

Both Congress and FERC have stressed that reliable low-cost electricity in each locality benefits not only consumers in that locality but also consumers and businesses elsewhere who use that locality's products.[7] Both Congress

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[7] *See* H.R. Rep. No. 102-474, pt. 1, at 133 (1992); Pet. App. 172a ("These potential benefits to the Nation's electricity consumers and the economy as a whole confirm the need to take generic action to remove barriers to competition."); Pet. App. 381a ("At the heart of these rules is a

and FERC also have stressed that interstate competition, enabling electricity to be produced and sold in each locality from whatever facilities can provide reliable electricity at the lowest delivered price, is now an important force in driving down prices and providing electricity as efficiently as possible. *See* H.R. Rep. No. 102-474, pt. 1, at 138 (1992) (The EPAct's "electricity provisions will promote additional competition . . . to improve the efficiency of the electric utility industry and secure the lowest possible costs for consumers."); *id.* at 133 (1992); Pet. App. 585a (lack of competition in the industry "harm[s] the economy as a whole").

It is equally clear that interstate competition to supply electric energy depends critically on nondiscriminatory access to interstate transmission. As FERC stressed, "[n]on-discriminatory open access to transmission services is critical to the full development of competitive wholesale generation markets and . . . lower consumer prices achievable through such competition." Pet. App. 608a. Much progress has been made in improving the efficiency of electric generation, but "the advantages of these technological advances can be achieved only if more efficient generating plants can obtain access to the regional transmission grids." Pet. App. 591a. "In the absence of non-discriminatory open access tariffs, the development of fully competitive bulk power markets cannot occur, and consumers will be deprived of the benefits that would be expected from such a competitive market." Pet. App. 610a.

In the absence of regulation to enforce nondiscriminatory access, transmission owners have a strong

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requirement that prohibits owners and operators of monopoly transmission facilities from denying transmission access, or offering only inferior access, to other power suppliers in order to favor the monopolists' own generation and increase monopoly profits—at the expense of the nation's electricity consumers and the economy as a whole.").

incentive to discriminate (and FERC found they *are* discriminating, Pet. App. 213a-215a) in favor of their own uses of the transmission system and against competitors who must cross a given utility's portion of the grid. Discrimination can take many forms, affecting access, price, and reliability. To eliminate it (in part), FERC required transmission owners to file pro forma OATTs assuring that third parties can secure access to the grid through the same procedures as transmission owners, using the same reservation and scheduling processes, subject to the same terms and conditions of service, and paying the same prices for the same services. *See* Pet. App. 160a-161a, 178a. Under Order Nos. 888 and 888-A, "comparability of access" means, for example, that all transmission users must pay transmission owners the same per-unit charge as the owners themselves pay for the same quality of transmission service, Pet. App. 133a-138a (discounts); 178a; 243a-245a (rate discounts); 252a-254a; 263a-264a (discounts); 382a-383a (discounts); that all users are subject to the same nondiscriminatory curtailment procedures in periods of system constraint, Pet. App. 276a, 458a, and that all users bear proportionate shares of the responsibility for the "ancillary service" needed to maintain the stability and reliability of interconnected transmission services. Pet. App. 249a-251a.

But FERC concluded that it could not apply the OATT to most interstate transmissions: all transmissions bundled with retail sales. If that were right, then transmission-owning utilities would be free to discriminate in favor of their own uses and against their direct competitors. They would be free, for example, to charge more than they themselves pay for comparable interstate transmission service, and to give themselves more reliable or otherwise better transmission service than they provide to their competitors, because no agency, state or federal, could block such discrimination.

State regulators might or might not have the incentive to prevent such discrimination: some might wish instead to protect the local utility and its ability to prefer its own retail customers over other in-state users and over transmission-dependent retail customers in other states. But whether or not they have the incentive, states have no general constitutional authority to regulate the terms on which "their" utilities provide interstate transmission services; no state could, as FERC partially did in Orders Nos. 888 and 888-A, require utilities to file a pro forma tariff applicable to all such interstate services. *See Pub. Utils. Comm'n v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927) (Commerce Clause barred Rhode Island from regulating bundled wholesale of power from plant in Rhode Island to Massachusetts purchaser).[8]

This Court has made this precise point in discussing the parallel provision of the Natural Gas Act. In *LP&L*, *supra*, the Court noted that if the FPC's jurisdiction were limited to transportation of gas for wholesale sales, no agency, federal or state, could effectively prevent transportation facilities owners from discriminating in favor of their own retail customers. *See* 406 U.S. at 641. Exactly the same constitutional point applies here: if FERC does not have jurisdiction to eliminate discrimination between bundled and unbundled transmission, then no agency can protect against

---

[8] Moreover, to the extent the states have any pertinent regulatory power, the regulatory regime established by the D.C. Circuit's decision will inevitably create conflicts between the states. *See LP&L*, 406 U.S. at 633. Producing states and consuming states have different incentives with respect to requiring "their" in-state utilities to provide nondiscriminatory open access to their facilities. For example, Utah might wish to keep all retail sales of power bundled, and therefore not subject to the OATT, in order to limit the amount of interstate transmission capacity that is available either to export some of the state's inexpensive coal and geothermal generation to Arizona or California or to ensure that inexpensive coal generation from Wyoming's Power River Basin can flow no further west than Utah, and not through Utah to Nevada or California.

this type of discrimination, which targets primarily competitors of the transmission owner.

The particular regulatory regime established by the decision below (bifurcating the uses of the interstate grid into "unbundled" uses subject to the OATT and "bundled" uses exempt from it), also enables transmission owning utilities to play a very unfair shell game. By initially characterizing its own power generation or power purchases as intended for bundled delivery to retail customers, a transmission owning utility can reserve and schedule use of its portion of the interstate grid at no charge, free of functional unbundling requirements. Later, before power actually flows, the utility can compare its cost to generate or purchase the power with the price at which it can resell the power "off-system" in the wholesale market. If that price is attractive, the transmission owner diverts as much of the power as it can into the competitive wholesale market. The transmission owning utility will then have obtained at no charge, and not subject to the OATT, transmission that all of its third-party competitors must pay for. Since electrons are indistinguishable, this shell game is nearly impossible to police by FERC, competitors, or state regulators.

This Court recognized long ago, in the Natural Gas Act context, that the policy of the statutes is to fill such gaps in regulatory authority. In *FPC v. Transcon. Gas Pipe Line Corp.*, 365 U.S. 1 (1961) (*Transco*), the Court held that, because Congress intended the NGA to "create a comprehensive and effective regulatory scheme," *id.* at 19 (quotation and citation omitted), where states lack power to address issues relating to the transmission or sale of energy, all doubts must be resolved in favor of federal jurisdiction, because "the conclusion is irresistible that Congress desired regulation by federal authority rather than nonregulation," *id.* at 28. In *LP&L*, *supra*, the Court reiterated the point: "'[I]n a borderline case where congressional authority is not explicit, [the Court] must ask whether state authority can

practicably regulate a given area, and if . . . it cannot, then [the Court is] impelled to decide that federal authority governs.'" *LP&L*, 406 U.S. at 631 (quoting *Transco*, 365 U.S. at 19-20). The question of FERC statutory authority presented in this case is vitally important, and should be resolved in favor of such authority, for the same reasons.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

JEFFREY D. WATKISS
BRACEWELL & PATTERSON, L.L.P.
2000 K Street, N.W.
Suite 500
Washington, D.C. 20006
(202) 828-5800

LOUIS R. COHEN
Counsel of Record
JOSEPH E. KILLORY, JR.
IJAY PALANSKY
MICHAEL PLOTNICK
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, D.C. 20037-1420
(202) 663-6000

Counsel for Petitioner Enron Power Marketing, Inc.

November 20, 2000

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OFFICE OF THE CLERK

No. __-___

IN THE

Supreme Court of the United States

ENRON POWER MARKETING, INC.,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI (Volume I)

JEFFREY D. WATKISS
BRACEWELL & PATTERSON, L.L.P.
2000 K Street, N.W.
Suite 500
Washington, D.C. 20006
(202) 828-5800

LOUIS R. COHEN
Counsel of Record
JOSEPH E. KILLORY, JR.
IJAY PALANSKY
MICHAEL PLOTNICK
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, D.C. 20037-1420
(202) 663-6000

Counsel for Petitioner Enron Power Marketing, Inc.

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APPENDIX A

Judgment of the United States Court of Appeals for the District of Colombia Circuit filed June 30, 2000

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 97-1715 September Term, 1999

Transmission Access Policy Study Group, et al.
Petitioner

v.

Federal Energy Regulatory Commission,
Respondent

Vermont Department of Public Service, et al.,
Intervenors

Consolidated with 98-1111, 98-1112, 98-1113, 98-1114, 98-1115, 98-1118, 98-1119, 98-1120, 98-1122, 98-1124, 98-1125, 98-1126, 98-1127, 98-1128, 98-1129, 98-1131, 98-1132, 98-1134, 98-1136, 98-1137, 98-1139, 98-1140, 98-1141, 98-1142, 98-1143, 98-1145, 98-1147, 98-1148, 98-1149, 98-1150, 98-1152, 98-1153, 98-1154, 98-1155, 98-1156, 98-1159, 98-1162, 98-1163, 98-1166, 98-1168, 98-1169, 98-1170, 98-1171, 98-1172, 98-1173, 98-1174, 98-1175, 98-1176, 98-1178, 98-1180

On Petitions for Review of Orders of the
Federal Energy Regulatory Commission

BEFORE: Sentelle, Randolph, and Tatel, *Circuit Judges*.

JUDGMENT

These causes came on to be heard on the petitions for review of orders of the Federal Energy Regulatory Commission and were argued by counsel. On consideration thereof, it is

ORDERED and ADJUDGED, by the Court, that the petitions for review are granted in part and denied in part, in accordance with the opinion for the Court filed herein this date.

FOR THE COURT:
Mark J. Langer, Clerk
By: s/Robert A. Bonner
Robert A. Bonner
Deputy Clerk

Date: June 30, 2000

Opinion Per Curiam

UNITED STATES COURT OF APPEALS
FOR DISTRICT OF COLUMBIA CIRCUIT
Filed: JUN 30 2000
Clerk

MANDATE
Pursuant to the provisions of Fed. R. App. Pro. 41(a)

ISSUED: 8/30/00

By: E. Brown

ATTACHED: –Amending Order
–Opinion
–Order on Costs

APPENDIX B

Opinion of the United States Court of Appeals for the District of Columbia Circuit filed June 30, 2000

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued November 3, 1999 Decided June 30, 2000

No. 97-1715

Transmission Access Policy Study Group, et al.
Petitioner

v.

Federal Energy Regulatory Commission,
Respondent

Vermont Department Of Public Service, et al.,
Intervenors

[Page 2]Consolidated with
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Bills of costs must be filed within 14 days after entry of judgment. The court looks with disfavor upon motions to file bills of costs out of time.

On Petitions for Review of Orders of the
Federal Energy Regulatory Commission

Sherilyn Peterson, John T. Miller, Jr., Robert C. McDiarmid, Stanley C. Fickle, Sara D. Schotland, Jeffrey L. Landsman, Lawrence G. Malone, Jeffery D. Watkiss, Richard M. Lorenzo, Isaac A. Benkin, Wallace E. Brand, Daniel I. Davidson, Cynthia S. Bogorad, Harvey L. Reiter and *Randolph Lee Elliott* argued the causes for petitioners. With them on the briefs were *William R. Maurer, Ben Finkelstein, David E. Pomper, Ronald N. Carroll, John Michael Adragna, Sean T. Beeny, Wallace F. Tillman, Susan N. Kelly, Craig W. Silverstein, A. Hewitt Rose, Bryan G. Tabler, James D. Pembroke, David C. Vladeck, Robert F. Shapiro, Lynn N. Hargis, Wallace L. Duncan, Richmond F. Allan, Alan H. Richardson, Michael A. Mullett, C. Kirby Mullen, Robert A. Jablon, Sara C. Weinberg, John F. Wickes, Jr., Todd A. Richardson, Brian A. Statz, John P. Cook, Charles F. Wheatley, Jr., Christine C. Ryan, Robert S. Tongren, Joseph P. Serio, Barry E. Cohen, Carrol S. Verosky, Jennifer S. McGinnity, Jonathan D. Feinberg, Charles D. Gray, Robert Vandiver, Cynthia Miller, Helene S. Wallenstein, William H. Chambliss, C. Meade Browder, Jr., Mary W. Cochran, Paul R. Hightower, Brad M. Purdy, Gisele L. Rankin, Robert D. Cedarbaum, Edward H. Comer, Edward Berlin,* [Page 3] *Robert V. Zener, Elizabeth W. Whittle, James H. McGrew, Donald K. Dankner, Frederick J. Killion, Joseph L. Lakshmanan, Stephen C. Palmer, Michael E. Ward, Steven J. Ross, Marvin T. Griff* and *Thomas C. Trauger. Leja D. Courter, Robert E. Glennon, Jr., Neil Butterklee, Zachary D. Wilson, Sheila S. Hollis, Janice L. Lower* and *James B. Ramsay* entered appearances.

John H. Conway, Deputy Solicitor, Federal Energy Regulatory Commission, and *Timm L. Abendroth* and *Larry D. Gasteiger*, Attorneys, argued the causes for respondent. With them on the brief was *Jay L. Witkin*, Solicitor. *Susan J.*

Court, Special Counsel, and *Edward S. Geldermann*, Attorney, entered appearances.

Edward Berlin argued the cause for intervenors. With him on the briefs were *J. Phillip Jordan, Robert V. Zener, Edward H. Comer, William M. Lange, Deborah A. Moss, James H. McGrew, Steven J. Ross, Elizabeth W. Whittle, Richard M. Lorenzo, David M. Stahl, D. Cameron Findlay, Peter Thornton, J. Phillip Jordan, Robert V. Zener, Robert C. McDiarmid, Cynthia S. Bogorad, Ben Finkelstein, Peter J. Hopkins, Margaret A. McGoldrick, Jeffery D. Watkiss, Ronald N. Carroll, Sara D. Schotland, Alan H. Richardson, Wallace L. Duncan, Richmond F. Allan, A. Hewitt Rose, Wallace F. Tillman, Susan N. Kelly, John M. Adragna, Sean T Beeny* and *Randolph Lee Elliott. Edward J. Twomey, Richard P. Bonnifield, Frederick H. Ritts, David L. Huard, Dan H. McCrary, Mark A. Crosswhite, John N. Estes, III, Kevin J. McIntyre, John S. Moot, Clark E. Downs, Martin V. Kirkwood, Robert A. Waters, John T. Stough, Jr., Bruce L. Richardson, Floyd L. Norton, IV, William S. Scherman, Douglas F. John, Gary D. Bachman, Nicholas W. Fels, Robert Weinberg, Robert A. Jablon, Peter G. Esposito, Christine C. Ryan, Sheila S. Hollis, Stephen L. Teichler, James K. Mitchell, Gordon J. Smith, Edward J. Brady, Kevin F. Duffy, Michael P. May, Barbara S. Brenner, Michael J. Rustum, Sandra E. Rizzo, Kirk H. Betts, Pierre F. de Ravel d'Esclapon, Glen L. Ortman* and *William D. DeGrandis* entered appearances.

[Page 4] Before: SENTELLE, RANDOLPH and TATEL, Circuit Judges.

Opinion for the Court filed PER CURIAM[1]:

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[1] Following our normal practice in complex cases, we shared the writing of this opinion. Judge Sentelle wrote Section II, Section III, and Section VII. Judge Randolph wrote Section IV, Section VI, and Section VIII. Judge Tatel wrote Section I Section V, and Section IX.

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Following two notices of proposed rulemaking, the Federal Energy Regulatory Commission issued Orders 888 and 889 on April 24, 1996[2]. Reflecting the Commission's effort to end [Page 7] discriminatory and anticompetitive practices in the national electricity market and to ensure that electricity customers pay the lowest prices possible, these orders represent, as the Commission described in a later order not before us, "the foundation necessary to develop competitive bulk power markets...." Regional Transmission Organizations, Order No. 2000, 65 Fed. Reg. 810, 812 (2000).

Open access is the essence of Orders 888 and 889. Under these orders, utilities must now provide access to their

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[2] Promoting Wholesale Competition Through Open Access Nondiscriminatory Transmission Services by Public Utilities, Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, FERC Stats. & Regs. ¶ 31,036, 61 Fed. Reg. 21,540 (1996), *clarified*, 76 FERC ¶ 61,009 and 76 FERC ¶ 61,347 (1996) ("Order 888"), on reh'g, Order No. 888-A, FERC Stats. and Regs. ¶ 31,048, 62 Fed. Reg. 12,274, clarified, 79 FERC ¶ 61,182 (1997), on reh'g, Order No. 888-B, 81 FERC ¶ 61,248, 62 Fed. Reg. 64,688 (1997), on reh'g, Order No. 888-C, 82 FERC ¶ 61,046 (1998); Open Access Same-Time Information System and Standards of Conduct, Order No. 889, FERC Stats. & Regs. ¶ 31,035, 61 Fed. Reg. 21,737 (1996) ("Order 889"), on reh'g, Order No. 889-A, FERC Stats. & Regs. ¶ 31,049, 62 Fed. Reg. 12,484 (1997), on reh'g, Order No. 889-B, 81 FERC ¶ 61,253 (1997).

transmission lines to anyone purchasing or selling electricity in the interstate market on the same terms and conditions as they use their own lines. By requiring utilities to transmit competitors' electricity, open access transmission is expected to increase competition from alternative power suppliers, giving consumers the benefit of a competitive market. Most fundamentally, FERC's open access policies, combined with parallel action now occurring on the state level, are intended to create a market in which customers may purchase power from any of a number of suppliers. A municipality or factory in Florida, for example, will no longer have to purchase power from its local utility but instead may seek cheaper power anywhere in the country. A customer in Vermont may purchase electricity from an environmentally friendly power producer in California or a cogeneration facility in Oklahoma.

All key players in the electricity market have challenged various provisions of Orders 888 and 889. Their claims range from the hypertechnical to arguments that FERC lacks authority to order open access transmission at all. Finding few defects in the orders we uphold them in nearly all respects.

I. INTRODUCTION

Historically, vertically integrated utilities owned generation, transmission, and distribution facilities. They sold gen-[Page 8]eration, transmission, and distribution services as part of a "bundled" package. Due to technological limitations on the distance over which electricity could be transmitted, each utility served only customers in a limited geographic area. And because of their natural monopoly characteristics, utilities have been heavily regulated at both the federal and state levels.

Since enactment of the Federal Power Act in 1935, the electricity industry has undergone significant change, both economically and technologically. Economies of scale have

justified the construction of large (greater than 500 MW) generation facilities, such as nuclear power plants. Technological advances in the 1970s and 1980s have permitted small plants to operate efficiently as well. See Notice of Proposed Rulemaking, Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, FERC Stats. & Regs. ¶ 32,514 at 33,059-60, 60 Fed. Reg. 17,662 (1995) ("Open Access NOPR"). Technological improvements also made feasible the transmission of electric power over long distances at high voltages. See id. ¶ 32,514 at 33,060. Alternative power suppliers, such as cogenerators, small power producers, and independent power producers emerged in response to these developments. Constructing and operating generation capacity at prices lower than the embedded generation costs of traditional utilities, these alternative suppliers have created a wholesale market for low-cost power.

The growth of this new wholesale market faced a serious obstacle. "As entry into wholesale power generation markets increased," FERC explained, "the ability of customers to gain access to the transmission services necessary to reach competing suppliers became increasingly important." Id. at 33,062. Yet the owners of transmission lines, the traditional utilities that had built the high-cost generation capacity, denied alternative producers access to their transmission lines on competitive terms and conditions. FERC therefore began requiring utilities to file open access transmission tariffs that permitted other suppliers to transmit power over [Page 9] their lines under certain circumstances, such as when a utility sought authorization to merge with another utility or to sell power at market-based rather than cost-based rates.

Then, in 1992, Congress enacted the Energy Policy Act, which amended sections 211 and 212 of the FPA to authorize FERC to order utilities to "wheel" power—i.e., transmit

power for Wholesale sellers of power over the utilities' transmission lines—on a case-by-case basis. Pub. L. No. 102-486, 106 Stat. 2776, 2915-16 (1992) (codified at 16 U.S.C. §§ 824j-k). FERC "aggressively implemented" amended sections 211 and 212 to "'facilitate the development of competitively priced generation supply options, and to ensure that wholesale purchasers of electric energy can reach alternative power suppliers and vice versa.'" Open Access NOPR, ¶ 32,514 at 33,064 (quoting Notice of Proposed Rulemaking, Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, FERC Stats. & Regs. ¶ 32,507 at 32,866, 59 Fed. Reg. 35,274 (1994) ("Stranded Cost NOPR")).

Despite these efforts, a persistent barrier to the development of a competitive wholesale power sale market remained. The Commission found that "utilities owning or controlling transmission facilities possess substantial market power, that, as profit maximizing firms, they have and will continue to exercise that market power in order to maintain and increase market share, and will thus deny their wholesale customers access to competitively priced electric generation; and that these unduly discriminatory practices will deny consumers the substantial benefits of lower electricity prices." Open Access NOPR, ¶ 32,514 at 33,052. Power generators not permitted to use utilities' transmission lines on reasonable terms have no way to transmit their power to customers.

Invoking its authority under sections 205 and 206 of the FPA to remedy unduly discriminatory or preferential rules, regulations, practices, or contracts affecting public utility rates for transmission in interstate commerce, 16 U.S.C. §§ 824d-e, and building on its experience in restructuring the natural gas industry, see Associated Gas Distribs. v. FERC, 824 F.2d 981 (D.C. Cir. 1987), the Commission issued Orders [Page 10] 888 and 889 to "prevent this discrimination by requiring all public utilities owning and/or controlling

transmission facilities to offer non-discriminatory open access transmission service." Open Access NOPR, ¶ 32,514 at 33,052. Orders 888 and 889 mandate what FERC terms "functional unbundling," i.e., separating utilities' wholesale transmission functions from their wholesale electricity merchant functions. Specifically, the orders require utilities to (1) file open access nondiscriminatory tariffs that contain the minimum terms and conditions of nondiscriminatory services prescribed by FERC through its pro forma tariff; (2) take transmission service for their own new Wholesale sales and purchases of electric energy under the same terms and conditions as they offer that service to others; (3) develop and maintain a same-time information system that will give potential and existing transmission users the same access to transmission information that the utility enjoys (called the "Open Access Same-Time Information System" or "OASIS"); and (4) state separate rates for wholesale generation, transmission, and ancillary services. See Order 888, ¶ 31,036 at 31,635-36.

In requiring utilities to provide open access transmission, FERC acknowledged the dramatic change the orders would bring about, explaining that "[t]he most critical transition issue that arises as a result of the Commission's actions in this rule-making is how to deal with the uneconomic sunk costs that utilities prudently incurred under an industry regime that rested on a regulatory framework and a set of expectations that are being fundamentally altered." Order 888-A, ¶ 31,048 at 30,346. Known as "stranded costs," these "uneconomic sunk costs" are costs that utilities incurred not only with regulatory approval, but with the expectation of continuing to serve their current customers. These costs will become "stranded" when customers take advantage of open access transmission to purchase cheaper power from suppliers other than their historic utilities. Order 888 affords utilities an opportunity to recover stranded costs from their wholesale requirements customers, but only from those customers who use their utility's transmission service to

purchase power from new suppliers, and only if the utility can [Page 11] prove that it had a reasonable expectation of continued service to that customer.

After three rehearing orders, the Commission denied any further rehearing. All petitions for review of Orders 888 and 889 were consolidated and transferred to this circuit. We consider these petitions in this opinion. Section II considers challenges to FERC's authority to require utilities to file open access tariffs as a remedy for undue discrimination. Section III evaluates FERC's conclusion that it lacked jurisdiction to order retail unbundling yet has jurisdiction over transmission where state commissions have unbundled retail sales. Section IV addresses FERC's authority to require nonpublic utilities to provide reciprocal open access transmission service. Section V considers challenges to Order 888's stranded cost recovery provisions. Section VI evaluates petitioners' arguments relating to credits for customer-owned facilities and behind-the-meter generation. Section VII addresses discounting interface allocation, and liability. Section VII evaluates other arguments relating to the terms and conditions of the pro forma tariff. Section IX assesses FERC's compliance with the National Environmental Policy Act and the Regulatory Flexibility Act.

In the end, we affirm the orders in all respects except two: we remand for FERC to explain its treatment of energy costs in the stranded cost market option (Section V.A.5.c) and to provide a reasonable cap on contract extensions under existing customers' right-of-first-refusal (Section VIII.E).

II. FERC'S AUTHORITY TO REQUIRE OPEN ACCESS

Although FERC asserts that "mounting claims of undue discrimination in transmission access" prompted its movement toward open access, the open access requirement of Order 888 is premised not on individualized findings of discrimination by specific transmission providers, but on FERC's identification of a fundamental systemic problem in

the industry. Generally, those entities that own or control interstate transmission facilities are vertically-integrated public utilities that also generate and sell electricity. In its 1995 [Page 12] notice of proposed rulemaking, FERC observed that there were at that time approximately 328 public utilities, marketers, and wholesale generation entities with transmission needs, and that approximately 137 of those owned or controlled the transmission facilities. See Open Access NOPR, ¶ 32,514 at 33,051. Entry into the transmission market is difficult and restricted, so those utilities that already own transmission facilities enjoy a natural monopoly over that field. The transmission-owning utilities can use their position to favor their own generated electricity and to exclude competitors from the market, whether by denying transmission access outright, or by providing transmission services to competitors only at comparatively unfavorable rates, terms, and conditions. Utilities that own or control transmission facilities naturally wish to maximize profit. The transmission-owning utilities thus can be expected to act in their own interest to maintain their monopoly and to use that position to retain or expand the market share for their own generated electricity, even if they do so at the expense of lower-cost generation companies and consumers.

Even before Order 888, some transmission-owning utilities voluntarily opened their transmission facilities to third party suppliers and purchasers of electricity; and FPA § 211 explicitly gives FERC the authority to order involuntary wheeling on a case-by-case basis. The Commission decided, however, that relying upon voluntary arrangements and § 211 orders would not remedy the fundamentally anti-competitive structure of the transmission industry. Instead, the Commission concluded, such a piecemeal approach would result in an inefficient "patchwork" of transmission systems nationwide. "The ultimate loser in such a regime is the consumer." Open Access NOPR, ¶ 32,514 at 33,071.

As an alternative, the Commission interpreted the anti-discrimination language of FPA §§ 205 and 206, 16 U.S.C. §§ 824d, 824e (1994), as giving it the authority to impose open access as a generic remedy for its findings of systemic anti—competitive behavior. Invoking that broad authority, in Order 888, FERC requires every transmission-owning public utility within FERC's jurisdiction to file an Open Access [Page 13] Transmission Tariff (OATT) containing minimum terms and conditions for non-discriminatory service and to take transmission service for their own wholesale sales and purchases of electric energy under those filed OATTs. In other words, this order requires the public utilities to provide the same transmission services to anyone purchasing or selling wholesale power—other public utilities, federal power suppliers and marketers, municipalities, cooperatives, independent power producers, qualifying facilities, or power marketers—as they provide to themselves. The Board of Water, Light and Sinking Fund Commissioners of the City of Dalton (Dalton) operates a municipally-owned utility system which provides electric power to residential, commercial, and industrial consumers in the city of Dalton, Georgia. Dalton obtains transmission services from the Georgia Integrated Transmission System (ITS), which it owns along with public utility George Power Company (GPC) and two other utilities that are not subject to FERC's jurisdiction, and which GPC operates according to the terms of various filed agreements. Puget Sound Energy, Inc. (Puget) is a public utility in the Pacific Northwest, where Bonneville Power Administration, which is not a public utility subject to Order 888's requirements,[3] [Page 14]

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[3] Bonneville Power Administration (BPA) "is a power marketing agency in the Pacific Northwest that markets power from thirty federal hydroelectric projects constructed and operated by the Corps of Engineers and the Bureau of Reclamation." In re Bonneville Power Administration, Power Sale and Transmission Rates, 54 F.E.R.C. ¶ 62,143 (1991). In Order 888, FERC concluded that BPA is not a public utility as defined by Federal Power Act (FPA) § 201(e), and thus is not subject to Order 888's

dominates the electricity transmission market. These two industry petitioners challenge the open access requirement of Order 888 on various statutory, constitutional, and other grounds.

Turning first to the FPA itself, Puget and Dalton argue that §§ 205 and 206 do not give the Commission the authority to order open access as a generic remedy; and even if the FPA does give the agency such authority, FERC has failed to satisfy the statutory requirements for invoking it. Dalton also argues that Order 888 itself violates the FPA by discriminating against transmission facility owners who have invested in those assets. Shifting to constitutional concerns, Puget and Dalton, along with amicus curiae Pacific Legal Foundation, maintain that Order 888 violates the Takings Clause of the Fifth Amendment. Finally, Dalton argues that the open access requirements of the OATT interfere with the antitrust conditions of outstanding nuclear licenses, and thus are unlawful. While we consider each of these challenges separately,[4] we hold that Order 888's open access

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requirements. Order 888, ¶ 31,036 at 31,858. FERC admitted, however, to three circumstances under which it might review BPA's transmission access and pricing policies: (1) if BPA files an open access tariff for review and confirmation under the Northwest Power Act and asks FERC to find that the tariff meets FERC's open access policies; (2) to the extent that BPA "is a transmitting utility subject to a request for mandatory transmission services" under FPA § 211; and (3) to the extent that BPA receives open access transmission from a public utility and is thereby subject to the reciprocity provision in that public utility's pro-forma tariff. Id.

[4] The Commission and various intervenors on its behalf argue extensively against our jurisdiction over these issues on the grounds that the petitioners failed, in various ways, adequately to raise their concerns before the agency and to preserve the issues for judicial review. Upon careful review of the record, we can safely conclude without further elaboration that these jurisdictional arguments are without merit, that the Commission has had ample notice and opportunity to address all of the petitioners' various statutory, constitutional, and other challenges to

requirement is authorized by and consistent with the FPA and the Takings Clause. We conclude also that Dalton has not yet suffered injury from the alleged conflict between open access and the nuclear license antitrust conditions, and that its complaint on that issue is therefore not yet ripe for judicial review.

A. Statutory Challenges: FPA §§ 205 and 206

Section 205 of the FPA broadly precludes public utilities, in any transmission or sale subject to FERC's jurisdiction, from "mak[ing] or grant[ing] any undue preference or advantage to [Page 15] any person or subject[ing] any person to any undue prejudice or disadvantage . . . ." 16 U.S.C. § 824d(b). Section 206 of the FPA further provides in relevant part that

> [w]henever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.

16 U.S.C. § 824e(a). The statutory issues before us are whether these provisions give FERC the authority to order involuntary wheeling as a generic remedy, and if they do, whether FERC satisfied the procedural and evidentiary requirements imposed by these provisions.

Order 888's open access requirement, and that we have jurisdiction to consider these issues.

1. §§ 205 and 206 and Otter Tail Power Company

The Commission did not write on a blank slate when it interpreted FPA §§ 205 and 206 as giving it the authority to order involuntary wheeling as a generic remedy for systemic anti-competitive behavior. Puget and Dalton argue principally that the Supreme Court's decision in Otter Tail Power Co. v. United States, 410 U.S. 366 (1973), controls the disposition of this issue. Otter Tail was an antitrust case in which the Supreme Court addressed whether the district court could require Otter Tail Power Company to wheel power for its competitors as a remedy for monopolistic practices. Contrary to the company's arguments, the Supreme Court concluded that the district court's order did not impermissibly conflict with the authority of the Federal Power Commission, FERC's predecessor, because the agency did not have the power itself to order involuntary wheeling under Part II of the FPA, which includes §§ 205 and 206. Puget and Dalton [Page 16] cite various circuit court precedents, including one from this circuit, as construing Otter Tail to prevent the Commission from ordering involuntary wheeling as a generic remedy. See, e.g., Florida Power & Light Co. v. FERC, 660 F.2d 668 (5th Cir. Unit B Nov. 1981); New York State Electric & Gas Corp. v. FERC, 638 F.2d 388 (2d Cir. 1980); Richmond Power & Light v. FERC, 574 F.2d 610 (D.C. Cir. 1978). Finally, Puget and Dalton note that subsequent to Otter Tail, Congress enacted FPA § 211, 16 U.S.C. § 824j, giving FERC the authority to impose open access on a case-by-case basis to remedy a broad range of problems. The petitioners argue that, if FPA §§ 205 and 206 authorize the Commission to impose open access, and if Otter Tail does not prohibit such action, then there was no reason for Congress to enact § 211.

In response, the Commission contends that we should not read Otter Tail as limiting its authority under FPA § 206 to remedy discriminatory behavior, since Otter Tail was an antitrust case and not an undue discrimination case. The

Commission also maintains that the circuit court cases cited by the petitioners are not on point and do not prohibit a generic open access remedy. The Commission points instead to our decision in Associated Gas Distributors v. FERC, 824 F.2d 981, 998 (D.C. Cir. 1987) (AGD), in which we upheld a similar open access transportation requirement imposed by FERC on natural gas transmission, as the controlling precedent. Finally, FERC argues that Congress enacted FPA § 211 to broaden its already existing authority to order involuntary wheeling, as FPA §§ 205 and 206 authorize such action only as a remedy for undue discrimination.

We agree with FERC that our decision in AGD controls the disposition of this issue. In AGD, we reviewed a FERC order imposing open access conditions on pipelines transporting natural gas. See 824 F.2d at 997-1001. Considering arguments quite similar to those made by the petitioners here, we concluded that Otter Tail does not constrain FERC from mandating open access where it finds circumstances of undue discrimination to exist. See id. at 998-99. Turning to relevant circuit precedent, we construed Richmond Power & Light as supporting only the proposition that a refusal to [Page 17] provide transmission services to another utility was not per se unduly discriminatory and we noted that the court in Florida Power & Light expressly left open the question of whether FERC could impose open access conditions as a remedy for anti-competitive behavior. See id. at 999. Further, we pointed out that our reading of Richmond is consistent with other precedent, specifically Central Iowa Power Coop. v. FERC, 606 F.2d. 1156 (D.C. Cir. 1979), in which we upheld FERC's use of its authority to prevent undue discrimination to condition its approval of a power-pooling agreement upon removal of membership criteria which denied certain privileges to some but not all participants. See AGD, 824 F.2d at 999. Indeed, in AGD, we noted that open access relies upon the very same principles that we upheld in Central Iowa. See id. Although AGD addressed open access under the anti-discrimination

provisions of the Natural Gas Act (NGA) rather than FPA §§ 205 and 206, we have repeatedly recognized the similarity of the two statutes and held that they should be interpreted consistently. See Environmental Action v. FERC, 996 F. 2d 401, 410 (D.C. Cir. 1993); Tennessee Gas Pipeline Co. v. FERC, 860 F.2d 446, 454 (D.C. Cir. 1988); see also Arkansas La. Gas Co. v. Hall, 453 U.S. 571, 577 n.7 (1981). Thus, AGD counsels the conclusion that, while Otter Tail may represent a general rule that FERC's authority to order open access is limited, the FPA, like the NGA, makes an exception to that rule where FERC finds undue discrimination.

Moreover, as in AGD, the deferential standard of Chevron U.S.A. Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984), governs our review of FERC's interpretation of FPA §§ 205 and 206. See AGD, 824 F.2d at 1001. If we agreed with Puget and Dalton that the Supreme Court's Otter Tail opinion dictates a particular construction of §§ 205 and 206, then the Commission's contrary interpretation would not be entitled to Chevron deference. See Maislin Indus., U.S., Inc. v. Primary Steel, Inc., 497 U.S. 116, 131 (1990) ("Once we have determined a statute's clear meaning, we adhere to that determination under the doctrine of stare decisis, and we judge an agency's later interpretation of the statute against [Page 18] our prior determination of the statute's meaning."). But having concluded that Otter Tail does not govern the disposition of this case, we are faced solely with considering the validity of FERC's interpretation of the FPA, a statute that the Commission administers. In AGD, we concluded that FERC reasonably interpreted the NGA's ambiguous anti-discrimination provisions as giving it broad authority to remedy unduly discriminatory behavior through a generic open access requirement. See AGD, 824 F.2d at 1001. Given the FPA's similar language, we can only reach the same conclusion with respect to Order 888. For all of these reasons, we find that the Commission has the

authority under FPA §§ 205 and 206 to require open access as a generic remedy to prevent undue discrimination.

2. § 206(a) Procedural and Evidentiary Requirements

Puget and Dalton next argue that, even if FPA §§ 205 and 206 authorize FERC to impose open access generically, § 206(a) imposes certain procedural and evidentiary requirements for action which the Commission failed in two separate but related ways to satisfy. First, the petitioners claim that FPA § 206(a) requires substantial evidence of contemporaneous "unjust, unreasonable, unduly discriminatory or preferential" behavior before the Commission can act. The Commission made no finding of discrimination or monopoly control on the part of Georgia Power Company or Puget. None of the applications or complaints filed with the Commission accused these petitioners of unduly discriminatory or anti-competitive behavior. Instead, the Commission premised Order 888 on a generic finding that public utility holders as a group have sufficient monopoly power over the transmission of electricity to engage in unduly discriminatory and anti-competitive practices, and that this condition will worsen in the future. To support its finding, the Commission relied upon unsubstantiated allegations of discriminatory conduct in public comments, its own experience in reviewing applications and complaints, and its own understanding of the incentives for monopolists to behave discriminatorily.

[Page 19] Puget and Dalton additionally assert that FPA § 206(a) requires that the requisite findings of undue discrimination be made in the context of a hearing. Although they concede that a rulemaking proceeding can satisfy the statute's hearing requirement, Puget and Dalton maintain that the rulemaking proceeding nevertheless must clearly identify the challenged activities and actors, and give the accused actors the opportunity to demonstrate that their activities were not unlawful. The petitioners protest that the

Commission's notice-and-comment rulemaking process did not afford them such opportunity.

FERC claims the discretion under NLRB v. Bell Aerospace Co., 416 U.S. 267, 293 (1974), to choose between rulemaking and case-by-case adjudication; and FERC contends that its generic rulemaking process fully satisfied the requirements of FPA § 206(a). FERC concedes that it relied upon general findings of systemic monopoly conditions and the resulting potential for anti-competitive behavior, rather than evidence of monopoly and undue discrimination on the part of individual utilities. Citing our opinion in Wisconsin Gas Co. v. FERC, 770 F.2d 1144, 1166 (D.C. Cir. 1985), however, FERC maintains that such findings are sufficient to substantiate its decision to impose the open access requirement. Finally, FERC observes that we rejected these same arguments in AGD. See 824 F.2d at 1008 (citing Wisconsin Gas, 770 F.2d at 1165-68).

Again, we must agree with the Commission. In American Public Gas Ass'n v. FPC, we held that the Commission could exercise its authority under NGA § 5(a), the provision parallel to FPA § 206, through rulemaking as well as adjudication. See 567 F.2d 1016, 1064-67 (D.C. Cir. 1977); See also Wisconsin Gas, 770 F.2d at 1153 (articulating the American Public Gas holding). Congress subsequently ratified the American Public Gas holding when it enacted the Department of Energy Organization Act, 42 U.S.C. § 7173(c) (1994). See Wisconsin Gas, 770 F.2d at 1153 n.8 (acknowledging the Act). That statute provides that "the establishment of rates and charges under the Federal Power Act [16 U.S.C. 791a et seq.] or the Natural Gas Act [15 U.S.C. 717 et seq.], may be conducted by [Page 20] rule making procedures." 42 U.S.C. § 7173(c) (brackets in original). By passing a statute adopting the holding of American Public Gas, and explicitly applying that rule to the FPA as well as the NGA, Congress signaled its intent that the

hearing requirements of NGA § 5(a) and FPA § 206(a) be interpreted similarly.

Interpreting the hearing requirement of NGA § 5(a), we have said that, while the Commission cannot rely solely on "unsupported or abstract allegations," the agency is also not required to make "specific findings," so long as the agency's factual determinations are reasonable. See Wisconsin Gas, 770 F.2d at 1158. In AGD, we applied Wisconsin Gas in holding that the Commission was not required to make specific findings that individual rates charged by individual pipelines were unlawful, or to offer empirical proof for all the propositions upon which its order depended, before promulgating a generic rule to eliminate undue discrimination. See AGD, 824 F.2d at 1008-09. Upon comparison of the order considered in AGD with Order 888, if anything, FERC more thoroughly documented the reasons for its actions in Order 888 than in the earlier natural gas order.

Puget claims that AGD and Wisconsin Gas are distinguishable, and that this case is governed by Electricity Consumers Resource Council v. FERC, 747 F.2d 1511 (D.C. Cir. 1984), in which we reversed FERC's adoption of a rate based on an economic theory in the absence of a discussion of the practical applications of that theory. See 747 F.2d at 1514. As the AGD court recognized, however, the court in Electricity Consumers was persuaded that the Commission had distorted the economic theory it claimed to apply. See AGD, 824 F.2d at 1008. Just as the pipelines in AGD did, Puget has failed to articulate exactly how FERC has distorted the theories on which it relies in Order 888. Additionally, the AGD court rejected the idea that "Electricity Consumer's reference to 'economic theory' was intended to invalidate agency reliance on generic factual predictions merely because they are typically studied in the field called economics." Id. Following the rationale of Wisconsin Gas

and AGD, we conclude that [Page 21] FERC has satisfied the requirements for invoking its authority under FPA § 206(a).

3. Discriminatory Effect of Order 888

Dalton charges that, even if the FPA permits FERC to impose involuntary wheeling generally, the open access requirement of Order 888 causes rather than remedies discrimination, and therefore violates FPA § 206(a)'s express requirement that FERC act against undue discrimination. Specifically, Dalton and the other non-jurisdictional owners of the Georgia ITS facilities invested millions of dollars in those facilities in order to use the facilities each owns and receive reciprocal open access transmission services from the other owners. Under the Open Access Transmission Tariff (OATT), other customers do not have to make such investments to use the Georgia ITS facilities. FERC responds that Order 888 does not unduly discriminate between old and new customers of integrated transmission systems like the Georgia ITS; and that if Dalton has evidence that the tariff results in undue discrimination in its individual circumstances, Dalton remains free to file a petition under FPA § 206 for redress, and FERC will consider its claim.

FERC's conclusion that its open access requirement is not unduly discriminatory is subject only to arbitrary and capricious review. See 5 U.S.C. § 706(2)(A) (1994); Sithe/Independence Power Partners, LP v. FERC, 165 F.3d 944, 948 (D.C. Cir. 1999); Union Pacific Fuels, Inc. v. FERC, 129 F.3d 157, 161 (D.C. Cir. 1997). We conclude that FERC has adequately explained why its open access requirement is not unduly discriminatory. Relying upon extensive commentary as well as its own experiences, FERC concluded that, as a general matter, transmission industry conditions were conducive to discriminatory practices and anti—competitive behavior, such that case-by-case adjudication could not adequately address the problem. FERC also recognized that its generic findings may have exceptions, and thus that Order 888 may in individual

circumstances have a different result than that intended. Therefore, Order 888 does not preclude facilities owners the opportunity to argue their particular circum-[Page 22]stances in their OATT filings or, as with Dalton, in their own petitions for relief under FPA § 206(a). Rather, Order 888 merely shifts from a regulatory norm in which a user of transmission services must demonstrate to FERC an individualized need for open access to one in which a provider of transmission services must present to FERC individualized circumstances requiring relief from open access. As the petitioners have a mechanism by which they can seek relief for their particular concerns, we find nothing arbitrary or capricious about FERC's conclusion that its approach to open access is not unduly discriminatory.

In another stab at demonstrating the discriminatory effect of Order 888's open access requirement, Dalton alerts us to an agreement entered into between it and Georgia Power Company (GPC) in partial implementation of antitrust conditions contained in operating licenses issued by the Nuclear Regulatory Commission for jointly owned nuclear facilities connected to the Georgia ITS. Those antitrust conditions require GPC to provide Dalton with transmission services until the nuclear licenses expire, long after the ITS Agreement terminates. Dalton alleges that limitations imposed by Order 888 on Dalton's rights upon termination of the ITS Agreement are inconsistent with GPC's obligations under the nuclear licenses, and that the interference will result in discrimination against Dalton. FERC maintains that it agreed in addressing GPC's Order 888 compliance filing to treat the ITS Agreements separately.

Ultimately, Dalton has offered no present injury from the alleged conflict, so this issue is not ripe for review. Dalton will only be injured if, upon termination of the ITS Agreement, Order 888 interferes with Dalton's right to transmission services. Dalton's own argument suggests as much, observing that FERC "left to GPC the decision

whether it 'must, but cannot, comply with separate orders' of NRC and FERC and whether it will present evidence of such conflict to either Commission," and complaining that even if GPC does act, "the orders under review provide no assurance that the competitive transmission and other service rights provided by the nuclear licenses will be respected under the OATT." Br. [Page 23]of Petitioner Dalton at 23 (quoting Order 888-A, ¶ 41,048 at 30,452). In short, GPC and FERC are still in the process of determining whether the antitrust provisions even conflict with Order 888, as well as how to deal with any such inconsistency.[5] Accordingly, this issue is not appropriate for judicial review at this time.

B. Constitutional Challenge: Fifth Amendment Takings Clause

Puget and amicus curiae Pacific Legal Foundation (Pacific) contend that Order 888 violates the Takings Clause of the Fifth Amendment. These petitioners maintain that Order 888's open access requirement engineers a "taking" in two ways: First, that FERC's open access requirement effects a regulatory taking by arbitrarily changing pricing methodology in a way that excessively deprives transmission owners of their investments in facilities; and, second, that the open access requirement allows a physical invasion, a permanent physical occupation, by taking away the transmission owners' right to exclude competitors from their transmission property. We cannot grant relief on either ground.

When the action of the federal government effects a "taking" for Fifth Amendment purposes, there is no inherent constitutional defect, provided just compensation is available. At bottom, both of the petitioners' Fifth Amendment claims turn not on whether open access effects a taking, but whether

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[5] GPC's management of the Georgia ITS is subject to the direction of a committee that includes Dalton representatives.

FERC's cost-based transmission pricing policies in the end provide just compensation. The remedy of just compensation is not within our jurisdiction but that of the United States Court of Federal Claims, under the Tucker Act, 28 U.S.C. § 1491. See Bell Atlantic Tel. Cos. v. Federal Communications Comm'n, 24 F.3d 1441, 1444 n.1 (D.C. Cir. 1994); Railway Labor Executives' Ass'n v. United States, 987 F.2d 806, 815-16 (D.C. Cir. 1993).

We recognize that our jurisdiction to review an agency's construction of a statute necessarily involves an exercise of [Page 24]the policy of avoiding constitutional issues where possible, even though the issues may concern arguable takings amenable to Tucker Act remedy, "when 'there is an identifiable class of cases in which application of a statute will necessarily constitute a taking.'" Bell Atlantic, 24 F.3d at 1445 (D.C. Cir. 1994) (quoting United States v. Riverside Bayview Homes, Inc., 474 U.S. 121, 128 n.5 (1985)). We need not decide whether this case falls within that category, however, because even if it did, any takings problem created by Order 888 does not raise such significant constitutional doubt as to require us to construe the FPA to prohibit FERC from ordering open access. If there is a taking, and a claim for just compensation, then that is a Tucker Act matter to be pursued in the Court of Federal Claims, and not before us.

III. FEDERAL VERSUS STATE JURISDICTION OVER TRANSMISSION SERVICES

Vertically integrated utilities use their own facilities to generate, transmit, and distribute electricity to their customers. Traditionally, the customer paid one combined rate for both the power and its delivery, thus the industry refers to such sales as "bundled." To thc extent that bundled sales are made directly to the end user of the electricity, they are also recognized as retail sales. Utilities may also sell the electricity they generate at wholesale to other utilities or other resellers of power, which then resell that power to their own customers. Thus, the same utility may use its facilities

to serve both retail and wholesale customers. Vertically integrated utilities use their transmission facilities to move electricity over long distances, and use local distribution lines to deliver the electricity to the end user.

Even before Congress enacted the FPA, the Supreme Court held that states could not regulate wholesale sales of electricity. See Public Utils. Comm'n of R.I. v. Attleboro Steam & Elec. Co., 273 U.S. 83 (1927). A few years later in 1935, Congress included in the FPA a provision giving the Federal Power Commission, FERC's predecessor agency, the authority to regulate "the sale of [electric] energy at whole-[Page 25]sale," as well as "the transmission of electric energy in interstate commerce." FPA § 201(a), 16 U.S.C. § 824(a) (1994). FERC also limited federal regulation "to those matters which are not subject to regulation by the States," id., and reserved to the states "jurisdiction ... over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce...." FPA § 201(b), 16 U.S.C. § 824(b). Pursuant to these provisions, FERC has regulated wholesale power sales and interstate transmissions, and state agencies have retained jurisdiction over bundled retail transactions, including service issues and the intrastate sale and distribution of electricity through local distribution facilities.

Initially, as most transactions involved either a wholesale or a retail sale, and correspondingly transmission or local distribution facilities, this regulatory division of labor was straight-forward in application. Indeed, in 1935, when Congress enacted the FPA, the networks of high-voltage, long-distance transmission lines which today crisscross the United States did not exist. Instead, vertically integrated utilities individually built facilities sufficient to meet the power needs of their customers. Over time, however, the landscape of the electric industry changed.

Utilities decided to cover demand spikes by sharing power, rather than by building more generation capacity. The transmission grid developed from these arrangements. Eventually, nonutility generators started producing electricity; and power marketers began to buy and resell electricity to other power marketers, utilities, or even directly to consumers. These industry participants do not own transmission lines, so they rely upon the utilities that own such facilities to provide transmission services. In addition to their traditional bundled sales activity, vertically integrated utilities started "unbundling" their own services and developing their own power marketing units to buy and sell electricity at wholesale. Some states even mandate unbundling of retail services. As a result of these changes, facilities once used solely for local distribution of bundled retail sales now engage regularly in [Page 26]unbundled wholesale transmissions and retail delivery as well. Thus, while the electricity world once neatly divided into spheres of retail versus wholesale sales and local distribution versus transmission facilities, such is no longer the case.

In Order 888, FERC reinterpreted FPA § 201 to accommodate the new industry practices and conditions. FERC left the regulation of bundled retail transmissions to the states, concluding that "when transmission is sold at retail as part and parcel of the delivered product called electric energy, the transaction is a sale of electric energy at retail." Order 888, ¶ 31,036 at 31,781. Nevertheless, FERC asserted jurisdiction over all unbundled retail transmissions, and left to the states only the sales portion of unbundled retail transactions, on the ground that FPA § 201 gives it jurisdiction without qualification over all transmission by public utilities in interstate commerce. See id. Also, while acknowledging that FPA § 201(b) explicitly places retail transmissions by "facilities used in local distribution" beyond the Commission's jurisdiction, FERC adopted a seven factor jurisdictional test for determining which facilities fall within that category, and claimed exclusive authority over those that

do not. See id. at 31,780, 31,784. In the present litigation, each of these changes is challenged, with some petitioners claiming that FERC went too far, and others contending that the Commission did not go far enough in asserting jurisdiction.

A. Bundled Retail Sales

Several state regulatory commissions complain that FERC exceeded the boundaries of its statutory authority by asserting jurisdiction over unbundled retail transmissions. These state petitioners argue that the plain meaning and history of FPA § 201(a) gives FERC the authority to regulate only transmissions of electricity consumed in a state other than that in which the electricity was generated, if the transmission was not otherwise subject to state regulation. The states historically have regulated retail transmissions as part of bundled retail sales of electricity, while FERC has regulated wholesale transmissions; and the division of regulatory jurisdiction should not change merely because those transac-[Page 27]tions have now been unbundled into separate generation, transmission, and sales components.

Two groups of transmission dependent utilities, TAPS and TDU Systems, and the nation's largest power wholesaler, Enron Power Marketing (collectively the "unbundling and discounting" or "U&D" petitioners), both intervene on the side of FERC with respect to the states' claim, and separately challenge FERC's interpretation of its jurisdiction on different grounds. The U&D petitioners contend that FERC impermissibly limited its jurisdiction by leaving the regulation of bundled retail transmissions to the states. These parties maintain that FERC has the authority to regulate both bundled and unbundled retail transmissions, and that FERC violates FPA § 206 by limiting the scope of Order 888 to the latter. To establish that bulk transmission by utilities is transmission in interstate commerce regardless of whether the power is sold at wholesale or retail, the U&D petitioners cite particularly FPC v. Florida Power & Light

Co., 404 U.S. 453 (1972), and Jersey Central Power & Light Co. v. FPC, 319 U.S. 61 (1943), two of the cases relied upon by FERC in the Notice of Proposed Rulemaking, ¶ 32,514 at 33,135-42. As further support that FERC's jurisdiction extends to all interstate transmissions, the U&D petitioners offer NGA precedent recognizing FERC's authority over all interstate gas transportation, if not the gas being transported. See, e.g. FPC v. Louisiana Power & Light Co., 406 U.S. 621, 636 (1972); United Distribution Cos. v. FERC, 88 F.3d 1105, 1153 (D.C. Cir. 1996) (UDC); Mississippi River Transmission Corp. v. FERC, 969. F.2d 1215 (D.C. Cir. 1992). These petitioners contend that excluding bundled retail transmissions from the OATT will permit discrimination and give owners a competitive advantage, contrary to the mandate of FPA § 206(a) that FERC eliminate undue discrimination. Accordingly, the U&D petitioners claim that FERC erred when it declined to mandate functional unbundling for an owner's transmissions to bundled retail customers of (1) its own generated power or (2) power purchased at wholesale.

In response to these challenges, FERC maintains that the plain meaning of FPA § 201 gives the Commission jurisdic-[Page 28]tion over all interstate transmissions without qualification, while at the same time limiting jurisdiction over sales to wholesale sales. Relying particularly on Florida Power & Light and Jersey Central Power & Light, FERC asserts broad jurisdiction over all transmission activities in interstate commerce. As for bundled retail sales, FERC's position is that once the transmission service is bundled with generation and local distribution, it becomes merely a component of the retail sale itself, over which FERC has no jurisdiction. FERC maintains that natural gas jurisprudence is inapplicable because the language of the NGA and FPA differ on this issue, and the natural gas cases turned on the existence of a regulatory gap that does not exist in the electricity field. FERC also asserts that its interpretation of the FPA's jurisdictional grant is entitled to deference under

Chevron U.S.A. Inc. v. Natural Resources Defense Council, 467 U. S. 837 (1984).

Both FPA § 201(a) and (b) clearly and unambiguously confer upon FERC jurisdiction over the "transmission of electric energy in interstate commerce." FPA § 201(c) further provides that "electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof." 16 U.S.C. § 824(c). In both Florida Power & Light and Jersey Central Power & Light, the Supreme Court considered whether certain indirect transmissions of electrical power across state lines represented transmissions in interstate commerce.

Jersey Central Power & Light involved the transmission of energy generated by Jersey Central in New Jersey. Jersey Central transmitted electricity to the New Jersey transmission facilities of another company, Public Service, which then transmitted the power first to another of its New Jersey facilities, and then on to a facility owned by yet a third company and located in the middle of a body of water separating New Jersey from Staten Island, New York. The third company in the chain then transmitted the energy first to its own facilities in New York, then finally and ultimately to consumers in New York. Jersey Central's own transmission facilities were located solely in New Jersey, and as were [Page 29]the facilities used by Public Service to receive the transmissions from Jersey Central.

The Supreme Court recognized that Jersey Central had no control over the transmissions' destination once the electricity was delivered to Public Service, see Jersey Central, 319 U.S. at 65, and that the total flow of electricity from Jersey Central to New York was small. See id. at 66. Nevertheless, because some electricity generated by Jersey Central in New Jersey was consumed in New York, the Court upheld FERC's jurisdiction under FPA § 20l, over Jersey Central's transmission facilities as utilized for transmissions in interstate's commerce. See id. at 67. The Court said that,

under FPA § 201(a) and (b), FERC's power extends over all facilities "which transmit energy actually moving in interstate commerce." Id at 72. The Court emphasized, however, that "mere connection" of one utility's transmission facilities to those of another transmitting in interstate commerce was insufficient for jurisdiction under FPA § 201. Id.

The Court revisited the issue in Florida Power & Light, which involved certain Florida and Georgia utilities who voluntarily connected their transmission facilities to coordinate their activities and exchange power as required to meet temporary needs. Like Jersey Central, FP&L's transmission facilities were confined to Florida, and none of FP&L's transmission lines directly connected with those of out-of-state companies. Nevertheless, because FP&L was a member of a group of interconnected utilities, its transmission lines connected with those of other Florida utilities; and the lines of one of those other utilities, Florida Power Corp., interconnected just short of Florida's northern border with those of Georgia Power Co. Records indicated that power transfers between FP&L and Florida Power coincided with transfers between Florida Power and Georgia Power.

In Jersey Central, logs of the relevant companies demonstrated at least a dozen occasions when facilities in New York drew power from certain lines at times when Jersey Central was the only supplier of electricity to those lines. See Florida Power & Light, 404 U.S. at 459. By way of contrast, [Page 30] there was no similar evidence that power generated by FP&L specifically passed through Florida Power to Georgia Power, with Florida Power serving as a mere conduit. See id. At best, company records demonstrated instances when transfers between FP&L and Florida Power occurred at or about the same time as transfers between Florida Power and Georgia Power. See id. at 457.

Instead, the Court considered two theories by which FP&L's power could be deemed transmitted across state lines. The first posited a cause and effect relationship by which every flick of a light switch would cause every generator on a multi-state interconnected system to produce some quantity of additional electricity to maintain the system's balance, and thus to transmit electric energy throughout the system and across state lines. The second theory suggested that where the transmission lines of two utilities interconnect, their energy commingles, such that inevitably some energy transmitted by FP&L to Florida Power was then transmitted to Georgia Power and across state lines.

Despite its statement in Jersey Central that "mere connection determines nothing," 319 U.S. at 72, the Court relied on the second of these theories to conclude that FP&L facilities were transmitting energy in interstate commerce, and left open the possible validity of the cause and effect theory. See 404 U.S. at 462-63. Writing in dissent, Justice Douglas characterized the Court's opinion as "mean[ing] that every privately owned interconnected facility in the United States...is within the [Federal Power Commission's] jurisdiction," such that otherwise local utilities would now be subject to the mandates of the federal bureaucracy. Id. at 471 (Douglas, J., dissenting).

The Supreme Court has interpreted the language in FPA § 201 regarding FERC's jurisdiction over transmissions in interstate commerce. We are bound by the High Court's dictates to conclude that the FPA gives FERC the authority to regulate transmissions at issue here, whether retail or wholesale. Even if the Court had not so spoken, however, and even if we independently concluded that the statute's text [Page 31]was less than clear, it is the law of this circuit that the deferential standard of Chevron U.S.A. Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984), applies to an agency's interpretation of its own statutory jurisdiction.

See Oklahoma Natural Gas Co. v. FERC, 28 F.3d 1281, 1283-84 (D.C. Cir. 1994). As guided by Chevron, unless Congress has directly spoken to the contrary, or FERC has unreasonably or impermissibly interpreted the statute, we must defer to the Commission's construction of ambiguous provisions of the FPA. See Chevron, 467 U.S. at 842-43. In this age of interconnected transmission grids, and given the accompanying technological complexities, we would be hard pressed to conclude that FERC's interpretation of § 201(c) as giving it jurisdiction over both wholesale and retail transmissions is unreasonable or impermissible.

Nevertheless, we are not persuaded that this conclusion requires FERC to mandate unbundling and assert jurisdiction overall retail transmissions. Just as FPA § 201 gives FERC jurisdiction over transmissions in interstate commerce and sales at wholesale, the statute also clearly contemplates state jurisdiction over local distribution facilities and retail sales. The statute is much less clear about exactly where the lines between those activities are to be drawn. A regulator could reasonably construe transmissions bundled with generation and delivery services and sold to a consumer for a single charge as either transmission services in interstate commerce or as an integral component of a retail sale. Yet FERC has jurisdiction over one, while the states have jurisdiction over the other. FERC's decision to characterize bundled transmissions as part of retail sales subject to state jurisdiction therefore represents a statutorily permissible policy choice to which we must also defer under Chevron. Accordingly, we affirm FERC's decisions in Order 888 to assert jurisdiction over unbundled retail transmissions while leaving regulation of bundled retail transmissions to the states.

B. Local Distribution Facilities

FPA §201(b) explicitly excludes from FERC jurisdiction "facilities used in local distribution or only for the transmis-[Page 32]sion of electric energy in intrastate commerce." 16

U.S.C. § 824(b)(1). Historically, wholesale sales have not for the most part involved local distribution facilities. FERC claims that increased unbundling gives resellers the opportunity to reconfigure the wholesale sales so that they might now occur on those facilities which traditionally have been treated as local distribution facilities. Moreover, FERC's assertion of jurisdiction over the transmission component of unbundled retail sales blurred the line between local distribution facilities and facilities used for transmission in interstate commerce.

In Order 888, FERC claimed exclusive authority over the regulation of facilities which sell and transmit electricity at wholesale to customers who will resell the electricity to end users. With respect to unbundled retail sales, FERC acknowledged that transmissions by "facilities used in local distribution" are beyond the Commission's jurisdiction, while facilities engaged in interstate transmission are subject to FERC jurisdiction under FPA § 201(a). Thus FERC adopted a seven factor jurisdictional test to identify whether a facility is a local distribution facility subject to state jurisdiction or a facility engaged in interstate transmission subject to FERC jurisdiction.[6] In short, under Order 888,

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[6] The Commission's seven factor test involves evaluating on a case-by-case basis whether the activities of the facilities in question correspond with seven specific indicators of local distribution:

(1) Local distribution facilities are normally in close proximity to retail customers.

(2) Local distribution facilities are primarily radial in character.

(3) Power flows into local distribution systems; it rarely, if ever, flows out.

(4) When power enters a local distribution system, it is not reconsigned or transported on to some other market.

(5) Power entering a local distribution system is consumed in a comparatively restricted geographic area.

(6) Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.

(7) Local distribution systems will be of reduced voltage.

Order 888, ¶ 31,036 at 31,981.

when a [Page 33]public utility is engaged in wholesale transmission, FERC has jurisdiction regardless of the nature of the facility; but when the public utility is engaged in unbundled retail transmission, the facts and circumstances will determine whether the facilities are subject to FERC or state jurisdiction.

The state petitioners argue that FERC's dual approach radically expands its jurisdiction and violates Congress' explicit directive in FPA § 201(b) that regulation of local distribution facilities be left to the states. The states contend that Congress clearly intended to preserve state jurisdiction over local distribution facilities, regardless of whether the energy comes from out of state or the sale is a wholesale sale. The states maintain that, by claiming jurisdiction over any facility transporting energy for resale, regardless of whether the facility might otherwise be a local distribution facility under the seven factor test, FERC has adopted the circular reasoning that wholesale sales do not occur on local distribution facilities, so any facility that engages in wholesale activities is not a local distribution facility. The states contend further that FERC offers no reasoned analysis of why local distribution should be defined differently for wholesale versus retail sales. The states finally charge that, under Order 888, nearly identical facilities would be under federal jurisdiction and state jurisdiction for different customers receiving indistinguishable service. Such a situation, they contend, will only encourage energy marketers to choose their regulator by using middlemen to shift the point at which title to the power transfers, and thus undermine the jurisdictional certainty that Order 888 states is necessary for competition.

FERC responds that it is not asserting jurisdiction over local distribution facilities, but assers that when a public utility delivers unbundled energy at wholesale to a supplier for the purpose of resale to an end user, FPA § 201 gives FERC unqualified authority to assert jurisdiction over the

facility used to effect that transaction. When the public utility is engaged in unbundled retail transmission, however, [Page 34] the circumstances of a specific case will determine whether the facilities used are subject to FERC or state jurisdiction. The arguments by the states do no more than raise policy concerns which are for FERC and not the court. See Arent v. Shalala, 70 F.3d 610 (D.C. Cir. 1995).

Intervening again on FERC's behalf on this issue, the U&D petitioners add that FERC's use of different tests is appropriate given the differences in the two separate jurisdictional grants of FPA § 201. The interveners argue that, given the statute's clear grant to FERC of jurisdiction over all aspects of wholesale sales FERC is fully justified in employing a functional test to identify wholesale transmissions. In contrast, because FERC's jurisdiction over retail sales is limited to transmissions in interstate commerce, the seven factor test is more appropriate.

We agree that FERC's dual approach to assessing its jurisdiction stems from the fact that FPA § 201 contains more than one jurisdictional grant. FPA § 201(b) denies FERC jurisdiction over local distribution facilities "except as specifically provided in this subchapter and subchapter III. 16 U.S.C. § 824(b)(1) (emphasis added). FPA § 201(a) makes clear that all aspects of wholesale sales are subject to federal regulation, regardless of the facilities used. FERC's assertion of jurisdiction over all wholesale transmissions, regardless of the nature of the facility, is clearly within the scope of its statutory authority. Moreover, various cases support the proposition that FERC regulates all aspects of wholesale transactions. See, e.g., Duke Power Co. v. FPC, 401 F.2d 930, 935-36 (D.C. Cir. 1968) (noting that the FPC regulates public utility facilities used in wholesale transmissions or sales in interstate commerce); Arkansas Power & Light Co. v. FPC, 368 F.2d 376, 383 (8th Cir. 1966) (stating that the functional use of the transmission lines—wholesale versus retail—controls); Wisconsin-

Michigan Power Co. v. FPC, 197 F.2d 472, 477 (7th Cir. 1952) (finding that transmission facilities used at wholesale are not "local distribution facilities").

[Page 35] The seven factor test applies only to unbundled retail sales, where FERC seeks to regulate pursuant to the separate grant of jurisdictional authority over transmissions in interstate commerce. In this context, the definition of "facilities used in local distribution" becomes relevant. The statute does not define "facilities used in local distribution," but instead leaves that task to FERC. As Chevron counsels us, FERC's interpretation of undefined and ambiguous statutory terms is entitled to deference. See Chevron, 467 U.S. at 842-43.

FERC has adopted a multi-factor test to determine the nature of transmission facilities. In a footnote, Order 888 says that distribution-only facilities which sell only at retail will still be considered local distribution facilities. See Order 888, ¶ 31,036 at 31,981 n.99. This is consistent with the fact that states historically have regulated bundled retail sales to end users. However, Order 888 implicitly recognizes the current reality that many primarily retail utilities engage in both local distribution and interstate transmissions, and seeks through the seven factors to discern each facility's primary function. We cannot agree with the state petitioners that this approach is unreasonable or otherwise impermissible.

IV. RECIPROCITY

Section 6 of the Tariff contains a reciprocity provision resting on the principle that any public utility offering "non-discriminatory open access transmission for the benefit of customers should be able to obtain the same non-discriminatory access in return." Order 888, ¶ 31,036 at 31,760. Non-public utilities—those outside the Commission's jurisdiction because, for instance, they are state-owned, see 16 U.S.C. § 824(f)—would otherwise not have to offer open-access. Under the Tariff, a public utility

does not have to offer them access unless they reciprocate. In order to avoid controversies between public and non-public utilities regarding reciprocal service, the Commission adopted a voluntary "safe harbor" provision pursuant to which non-public utilities could submit a transmission tariff to the Commission for a [Page 36]determination whether it satisfied the reciprocity condition. If it did, the public utility would have to offer service; if it did not, the public utility could refuse service (although it had the option of waiving the reciprocity condition, as did the Commission itself).

A. Indirect Regulation of Non-Jurisdictional Utilities

Nebraska Public Power District (NPPD), a state entity, provides electrical generation, transmission and distribution service to wholesale and retail customers throughout Nebraska.[7] It claims that the Commission, through the reciprocity provision, has reached beyond its statutory authority and is illegally attempting to regulate entities, including NPPD, over which the Commission has no jurisdiction, in violation of the Federal Power Act and the Tenth Amendment to the Constitution. NPPD admits that pursuant to Nebraska law, all state power districts are obligated to provide open access transmission service. They have been doing so for years. This is doubtless why, after Order No. 888 issued, another Nebraska public power district so easily obtained a safe harbor declaration. See Omaha Pub. Power Dist., 81 F.E.R.C. ¶ 61,054 (1997). In light of this, the Commission argues—and we agree—that NPPD's petition is unripe. Since NPPD already offers open access transmission, it is far from certain that the reciprocity

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[7] "Nebraska is unique among the States in the Union in that all generation, transmission and distribution service is provided by public entities, municipalities and cooperatives whose governing boards are responsible to, and serve at the voting pleasure of, the rate-payers they serve." NPPD Brief at 2.

provision will have any effect on it.[8] It certainly has not demonstrated any particular hardship that it would suffer if we refused to engage in pre-enforcement judicial review. See AT&T Corp. v. Iowa Utils. Bd., 525 U. S. 366, 386 (1999). From all that appears, no public utility has refused, or even threatened to refuse, to give NPPD access to its transmission system in the wake of [Page 37] Order No. 888.[9] Given the fact that public utilities may waive the reciprocity provision anyway, and that NPPD has the same option of obtaining a safe harbor as did the Omaha Public Power District, we are not persuaded that the provision is currently altering NPPD's conduct of its affairs or that withholding judicial review will cause it any hardship whatever. "Unlike the drug manufacturers in Abbott Laboratories [v. Gardner, 387 U.S. 136 (1967)], but like the cosmetics companies in Toilet Goods Ass'n v. Gardner, 387 U.S. 158, 164 (1967), NPPD need not change its "behavior or risk costly sanctions." Clean Air Implementation Project v. EPA, 150 F.3d 1200, 1205 (D.C. Cir. 1998). Furthermore, exactly how the Commission will fill in the contours of the reciprocity provision remains to be seen. That it may defer to state commissions) as it indicated in Houston Lighting & Power Co., 81 F.E.R.C. ¶ 61,015 (1997), order on reh'g, 83 F.E.R.C. ¶ 61,181 (1998), affects NPPD's contention that the Commission is seeking to bring about nationwide uniformity by forcing non-public utilities to comply with its "detailed mandates." NPPD Brief at 5. We therefore believe the issues raised would benefit from a more concrete setting in which NPPD can demonstrate exactly how the reciprocity provision has affected its primary conduct. See Clean Air

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[8] The Commission made clear that existing contracts will not be affected. See Order 888-A, ¶ 31,048 at 30,181.

[9] For this reason we find unpersuasive NPPD's claim that the Tariff's reciprocity provision places it at a disadvantage in negotiations because a public utility may simply refuse to provide service without any fear of a Commission enforcement action. See NPPD Reply Brief at 4-5.

Implementation Project, 150 F.3d at 1204. For all these reasons, NPPD's challenge to the reciprocity provision is not ripe for judicial review.

B. Limitation on Reciprocity

The Investor Owned Utilities (IOUs) challenge the following limitation on reciprocity: non-public utilities owe reciprocal open access only to the public utility from which they take open access service—not to all utilities. See IOU Brief at 40-44; IOU Reply Brief at 18-20. These petitioners argue that the Commission has left open the door for non-public utilities [Page 38] to discriminate against all other utilities and that it has done so solely because of tax considerations that no longer apply.

We agree with Commission counsel that tax considerations were not the only basis on which the Commission's limitation rested. The Commission stated that "the reciprocity requirement strikes an appropriate balance by limiting its application to circumstances in which the non-public utility seeks to take advantage of open access on a public utility's system." Order 888, ¶ 31,036 at 31,762. The Commission also explained that it "do[es] not have the authority to require non-public utilities to make their systems generally available." Id. at 31,761. The Commission stated also that it did not want broad open access reciprocity to jeopardize the tax-exempt financing non-public utilities enjoy,[10] that the IRS was then reexamining the question, id. at 31,762, and that if the tax issue is favorably resolved, it will reconsider the matter. Order 888-A, ¶ 31,048 at 30,287. The IRS has now acted. See Temporary Regulations § 1.141-7T(f), in 63 Fed. Reg. 3256 (1998). The IOUs argue that we must therefore remand for reconsideration. See IOU Brief at 44 (citing Panhandle Eastern Pipeline v. FERC, 890

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10 See 26 U.S.C. §§ 141, 142 (permitting "private activity" bonds and "local furnishing" bonds, respectively).

F.2d 435, 439 (D.C. Cir. 1989); National Fuel Gas Supply Corp. v. FERC, 899 F.2d 1244, 1249-50 (D.C. Cir. 1990); Ciba-Geigy v. EPA, 46 F.3d 1208 (D.C. Cir. 1995)).

We think not. So far as we know, the IRS has not finalized its temporary and proposed regulations. The IRS acknowledges that its temporary regulations "raised[ ] a number of complex technical issues" many of which "may need to be addressed legislatively" and it anticipates that the finalization process will take three years to accomplish. 63 Fed. Reg. at 3258-59. Second, as the Commission indicates, the possible tax consequences of requiring open access from non-jurisdictional utilities was its secondary concern. The Commission's greater concern was its lack of jurisdiction to do what the IOUs ask And lastly the Commission should be [Page 39] taken at its word that it will reconsider the scope of reciprocity when and if the temporary tax regulations are finalized.

V. STRANDED COST RECOVERY PROVISIONS

Ordering open access transmission, Order 888-A explains that "[t]he most critical transition issue that arises as a result of the Commission's actions in this rulemaking is how to deal with the uneconomic sunk costs that utilities prudently incurred under an industry regime that rested on a regulatory framework and a set of expectations that are being fundamentally altered." Order 888-A, ¶ 31,048 at 30,346. "If a former wholesale requirements customer or a former retail customer uses the new open access to reach a new supplier," FERC said, "we believe that the utility is entitled to recover legitimate, prudent and verifiable costs that it incurred under the prior regulatory regime." Order 888, ¶ 31,036 at 31,789.

According to FERC, these "stranded" costs consist pre dominantly of costs of building generation capacity, which utilities incurred with the expectation that they would use the additional capacity to serve existing customers. See Notice

of Proposed Rulemaking, Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, FERC Stats. & Regs. ¶ 32,507 at 32,863-64, 59 Fed. Reg. 35,274 (1994) ("Stranded Cost NOPR"). Because of the increased competition in the generation market that will result from open access, this capacity may become underutilized or uneconomical, i.e., "stranded." Stranded costs also include nonrecurring costs approved by regulators that, in order to avoid rate increases, were recovered over a period of years instead of at the time the expenditures were made. Known as "regulatory assets," these costs include deferred income taxes, deferred pension and other employee benefit and retirement costs, research and development, extraordinary property losses, and the phase-in of new plant costs. Nuclear decommissioning costs and costs to buy out high-priced fuel and power contracts may also become stranded as a result of open access.

[Page 40] Exercising its exclusive jurisdiction over wholesale power sales, FERC through Order 888 gave utilities the opportunity to recover their stranded costs from former wholesale customers who take advantage of open access transmission to purchase power from other suppliers. Order 888, ¶ 31,036 at 31,810. With respect to stranded costs resulting from state-ordered retail wheeling, Order 888 provides that FERC will consider stranded cost claims only when state regulatory agencies lack authority to do so. Id. at 31,824-25. Order 888 also designated FERC as the primary forum for stranded cost claims stemming from what are known as new municipalizations and municipal annexations. See Order 888-A, ¶ 31,048 at 30,404; Order 888-B, 81 FERC at 62,104. Stranded costs in these situations result from retail (as opposed to wholesale) power sales.

Petitioners challenge nearly every aspect of FERC's stranded cost policy as set forth in Order 888, from the mechanics of calculating customers' stranded cost obligations to whether FERC has authority to address

stranded costs at all. We begin with those challenges that relate to the recovery of wholesale stranded costs (Section V.A), then turn to challenges to Order 888's treatment of retail stranded costs (Section V.B). We affirm FERC's stranded cost policy in all respects, except we vacate that portion of the orders dealing with the treatment of energy costs in the market option and remand to FERC for further explanation. See Section V.A.5.c.

A. Wholesale Stranded Costs

In requiring nondiscriminatory open access transmission as a remedy for undue discrimination, FERC recognized that it "cannot change the rules of the game without providing a mechanism for recovery of the costs caused by such regulatory-mandated change." Order 888-A, ¶ 31,048 at 30,346. Under the pre-open access regulatory regime, utilities entered into long-term contracts to make wholesale power sales to municipal, cooperative, and investor-owned utilities. See Stranded Cost NOPR, ¶ 32,507 at 32,862. Because these customers had no source of power supply other than [Page 41] their historic utility, these contracts were typically extended at the end of their term. This produced an implicit obligation by the utilities to continue satisfying their customers' power needs, as well as a reciprocal expectation by customers of continued service. See id. at 32,863-64. To satisfy expected customer demand, utilities invested money, built facilities, and entered into long-term fuel or power contracts, relying on the "regulatory compact" under which utility shareholders accepted lower rates of return on their investment in exchange for the certainty of regulated rates and resulting ability to recover prudently incurred costs. See Notice of Proposed Rulemaking, Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, FERC Stats. & Regs. 32,514 at 33,049, 60 Fed. Reg. 17,662 (1995).

Order 888 fundamentally undermines utilities' expectation of continued service and cost recovery. A utility's requirements customers may now use the utility's open access transmission service to purchase power from other suppliers at the end of their contract terms. If customers leave before paying their share of costs the historic utility incurred on their behalf, the utility will be left with stranded costs, which it will either absorb or shift to remaining customers.

Unless utilities are able to recover stranded costs, FERC reasoned, their ability to compete and attract investor capital in a deregulated market may be seriously impaired. FERC therefore decided that it had to "address recovery of the transition costs of moving from a monopoly-regulated regime to one in which all sellers can compete on a fair basis and in which electricity is more competitively priced." Order 888, ¶ 31,036 at 31,635. In reaching this conclusion, FERC relied on its experience in restructuring the natural gas industry, where this court faulted it for failing to provide transitional mechanisms such as stranded cost recovery. FERC explained: "We have learned from our experience in the natural gas area the importance of addressing competitive transition issues early and with as much certainty to market participants as possible." Id.

[Page 42] In shaping its stranded cost recovery mechanism, FERC had to balance two competing interests: speeding the transition to competition versus protecting utilities that had incurred costs with the expectation that their customers would remain and eventually pay those costs through electricity rates. Allowing recovery of stranded costs, FERC acknowledged, would delay full realization of the benefits of open access-lower electricity rates—because customers facing stranded cost liability might continue purchasing power from their historic utility even though competitors are selling power at lower rates. See Order 888-A, ¶ 31,048 at 30,355. Indeed, a customer would only switch

suppliers if the competitor offered a rate less than the historic utility's rate plus the customer's stranded cost liability. But given the highly regulated nature of the electricity industry, in which utilities incurred costs with the expectation of recouping them, FERC concluded that the delay was a necessary component of its open access program. See id. Mindful of its ultimate goal of converting the electricity industry into a competitive market, however, FERC fashioned the stranded cost recovery provisions to be transitional, allowing utilities to recover stranded costs only in connection with wholesale requirements contracts entered into on or before July 11, 1994 (the date of the stranded cost notice of proposed rulemaking). See 18 C.F.R. § 35.26(b)(8), 35.26(c)(1)(v)-(vi).

As to precisely who should pay for stranded costs, utilities and customers not surprisingly had dramatically different positions. Customers argued that utilities should absorb most, if not all, stranded costs. Utilities (and their investors) argued that customers should pay.

Facing an enormously difficult task in balancing these sharply conflicting positions, FERC crafted a rule that requires customers to pay stranded costs but only in certain circumstances. Most important, in order to recover stranded costs from a customer, the historic utility must prove that it had a reasonable expectation of continued service to that particular customer for a certain number of years beyond the end of the contract term; a utility unable to prove such an expectation may not recover stranded costs under Order 888. [Page 43] See 18 C.F.R. § 35.26(c)(2)(i). Moreover, a utility able to demonstrate a reasonable expectation of continued service may recover stranded costs only if its wholesale customer actually takes advantage of the utility's open access tariff to obtain access to a new generation supplier at the end of its contract term (i.e., the former customer continues to use the historic utility's transmission service but no longer purchases power from it). See 18 C.F.R. § 35,26(b)(1)(i).

Through these two limitations, FERC balanced the interests of utilities and customers by allowing utilities to recover their stranded costs only if they can demonstrate a reasonable expectation of continued service and requiring customers to pay those costs only if they take advantage of their historic utility's open access transmission to reach cheaper sources of power. And of course, no customer will have to pay stranded costs at all if it continues purchasing power from its historic utility throughout the period during which the utility has a reasonable expectation of continued service—precisely what the customer would have done in the absence of Order 888's open access requirement.

Under Order 888, stranded costs are calculated on a "revenues lost" basis. A departing customer's stranded cost obligation equals the estimated revenue it would have paid had it continued to purchase power from the historic utility minus the current market value of the power it would have purchased, calculated over the period the utility is determined to have a reasonable expectation of continued service to that customer. See 18 C.F.R. § 35.26(c)(2)(iii). In other words, the stranded cost formula is not tied to particular stranded assets or contractual commitments, but rather awards utilities the difference between the pre-open access cost-based rate and the post-open access market rate. Once a customer's stranded cost liability is calculated, it may pay through a lump-sum payment, installment payments, or a surcharge to the transmission rate charged by the historic utility. See Order 888, ¶ 31,036 at 31,799.

Before turning to petitioners' arguments, we emphasize what should be obvious from the foregoing summary of Order 888: Order 888 awards stranded costs to no one. It does [Page 44] nothing more than establish a mechanism by which utilities may seek to recover stranded costs. To recover stranded costs, a utility must demonstrate its continued expectation of service at an evidentiary hearing. The customer may appear at that hearing and, through

evidentiary submissions of its own, attempt to demonstrate that the utility had no such expectation. Only after such a hearing may FERC decide whether a utility can recover stranded costs and, if so, how much.

Petitioners mount many challenges to Order 888's stranded cost recovery provisions. For purposes of analysis, we group these challenges into five categories: (1) challenges to FERC's authority to provide for stranded cost recovery (section V.A.1); (2) claims that Order 888 conflicts with cost causation principles and case law developed under the Natural Gas Act (section V.A.2); (3) challenges to FERC's Mobile-Sierra findings (section V.A.3); (4) claims that FERC arbitrarily and capriciously failed to provide for stranded cost recovery by certain entities, such as transmission dependent utilities and generation and transmission cooperatives (section V.A.4); and (5) challenges to various technical aspects of Order 888's stranded cost recovery provisions (section V.A.5).

1. FERC's Authority to Provide for Stranded Cost Recovery

A group called Petitioners Opposing Stranded Cost Recovery ("POSCR") advances three challenges to FERC's authority to provide for stranded cost recovery: (1) as a factual matter, utilities could never have had a reasonable expectation of continued service to wholesale customers beyond the contract term; (2) sections 206 and 212 of the Federal Power Act ("FPA") forbid stranded cost recovery; and (3) our decision in Cajun Elec. Power Coop., Inc. v. FERC, 28 F.3d 173 (D.C. Cir. 1994), holds that stranded cost recovery is anticompetitive. We consider each argument in turn.

a. Reasonable expectation of continued service

To recover stranded costs relating to a specific departing wholesale requirements customer, a utility must show that it [Page 45]had a reasonable expectation of service to that

customer beyond the term of its existing contract. See 18 C.F.R. § 35.26(c)(2)(i). Pointing out that contracts define the extent of the parties' obligations and that customers have long exercised their rights to purchase power from other suppliers at the end of their contract terms. POSCR contends that utilities could never have had an expectation of service beyond their contract terms. In considering this argument it is important to remember that Order 888 does not itself award stranded costs; it merely establishes a procedure by which utilities may petition FERC in individual proceedings to recover stranded costs from a specific customer based on a specific evidentiary showing. Utilities failing to show an expectation of continued service will be unable to recover stranded costs. POSCRs challenge thus amounts to a claim that no utility could ever, under any circumstances, have had a reasonable expectation to serve a wholesale customer beyond the term of its contract. We review this claim under the APA's familiar arbitrary and capricious standard. See 5 U.S.C. § 706(2)(A); Williams Field Services Group, Inc. v. FERC, 194 F.3d 110, 115 (D.C. Cir. 1999).

Responding to this same challenge in Order 888-A, FERC explained that utilities historically had an implicit obligation to serve customers beyond the contract term for a simple reason: Customers had no means of reaching alternative suppliers. See Order 888-A, ¶ 31,048 at 30,354. As part of that obligation to serve, FERC found, a local utility "had a concomitant obligation to plan to supply [its] customers' continuing needs, and planned its system taking account of the wholesale load. In many cases the wholesale customers participated by supplying load forecasts." Id. In making capital decisions and predicting future demand, utilities frequently consulted with their wholesale requirements customers. For these reasons, FERC concluded, utilities may have a reasonable expectation of continued service to particular customers. See id. at 30,354-55.

Not only is FERC's judgment about utilities' reasonable expectations precisely the type of policy assessment to which we owe great deference, but POSCR points to nothing sug-[Page 46]gesting that FERC's reasoning is arbitrary and capricious. In fact, POSCRs argument completely ignores the highly regulated nature of the electricity industry prior to Order 888. Unlike competitive markets, where buyers may freely purchase from many sellers, the monopolistic character of the electricity industry, combined with the congressionally imposed regulatory structure, left requirements customers highly dependent on a single supplier—their historic utility. Indeed, as interveners point out, utilities were even unable to choose not to renew an expiring wholesale requirements contract without first notifying FERC. See 18 C.F.R. § 35.15 (1995) (repealed by Order 888). Although it may well be true, as POSCR argues, that some wholesale customers have long been able to purchase unbundled transmission service, we think such evidence is best reserved for individual proceedings, where a department customer can attempt to refute the utility's claim that it had an expectation of continued service.

b. Sections 206 and 212 of the FPA

Section 206(a) of the FPA gives FERC authority to "determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force" if it finds that any existing arrangement "is unjust, unreasonable, unduly discriminatory or preferential." 16 U.S.C. § 824e(a). Relying on section 206(a) as the basis for Order 888, FERC found that utilities had used their monopoly transmission power to discriminate against potential competitors and that such practices would increase as competitive pressures in the industry increased. Order 888, ¶ 31,036 at 31,676, 31,682.

POSCR contends that Order 888's stranded cost recovery provisions themselves violate FERC's own construction of section 206, the construction FERC relied on

as the basis for the open access rule. According to POSCR, "[t]he stranded cost rule perpetuates the very 'discrimination' FERC found unlawful, and subjects the same victims—customers held hostage to uneconomic electric generation by transmission monopolists—to continued abuse."

[Page 47]In challenging FERC's policy decision to provide for stranded cost recovery, POSCR conflates the violation (FERC's generic determination that utilities' practice of prohibiting access to their transmission lines on reasonable terms was unduly discriminatory) with the remedy (FERC's more limited finding that recovery of stranded costs in particular circumstances would not be unduly discriminatory). FERC has not, as POSCR contends, given "unduly discriminatory" different meanings; rather, it has applied the term in different contexts.

POSCR's argument thus boils down to a challenge to FERC's conclusion that the stranded cost recovery prescribed in Order 888 is not unduly discriminatory, a challenge meriting arbitrary and capricious review. Viewed through this lens, we think FERC more than adequately explained why it concluded that stranded cost recovery is not unduly discriminatory—stranded cost recovery, FERC said, is transitional only, follows cost causation principles, and requires utilities to prove that they had a reasonable expectation of continued service. FERC faced an enormously difficult task. It had to balance the transition to competitive markets against the need to maintain the competitiveness of utilities that had incurred costs based on a reasonable expectation that they would recoup them. We find nothing either arbitrary or capricious in how FERC struck this balance.

POSCR next contends that stranded cost recovery violates section 212 of the FPA, which governs the rates for transmission ordered by FERC pursuant to section 211. 16 U.S.C. §§ 824j-k. Because FERC-jurisdictional utilities are no longer subject to sections 211 and 212, this argument

relates only to those situations in which FERC orders nonjurisdictional transmitting utilities to wheel under section 211 and these utilities then seek to recover stranded costs in their transmission rates. See 18 C.F.R. § 35.26(c)(1)(vi)-(vii). Section 212 allows FERC to order "rates, charges, terms, and conditions which permit the recovery by [a transmitting] utility of all the costs incurred in connection with the transmission services and necessary associated services, including, but not limited to, an appropriate share, if any, of legitimate, verifiable and [Page 48] economic costs, including taking into account any benefits to the transmission system of providing the transmission service, and the costs of any enlargement of transmission facilities." 16 U.S.C. § 824k(a). Contending that economic costs" cannot be read to include payment of stranded costs, which by definition relate to generation (not transmission) services, POSCR reads section 212 to preclude stranded cost recovery.

Straightforward application of the Chevron doctrine demonstrates the lack of merit in this argument. See Chevron, U.S.A., Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984). Because Congress has not "directly spoken to the precise question at issue"—do "economic costs" include stranded costs?—and because nothing in the statute precludes recovering through transmission rates costs that were traditionally recovered through generation rates, the term "economic costs" is ambiguous. Id. at 842.

Proceeding to Chevron's second step, we ask whether FERC has reasonably interpreted the term "economic costs." See id. at 843. We have no doubt that it has. As FERC explained, but for section 211 wheeling orders, there would be no stranded costs. Stranded costs, according to FERC, are therefore economic costs of section 211 wheeling. See Order 888-A, ¶ 31,048 at 30,390. POSCR offers nothing to undermine this eminently reasonable interpretation of the statute.

c. Implications of Cajun

Next, POSCR contends that our decision in Cajun Elec. Power Coop., Inc. v. FERC, 28 F.3d 173 (D.C. Cir. 1994), condemns stranded cost recovery as anticompetitive. A pre-Order 888 decision, Cajun reviewed two tariffs allowing a utility, Entergy Corporation, to sell power at market rates, and a third tariff providing for open access to Entergy's transmission services at cost-based rates. The third tariff gave Entergy an opportunity to recover stranded costs from customers who no longer purchase power from Entergy but use its transmission lines to reach other suppliers—exactly the circumstances in which Order 888 provides for stranded cost recovery. Under the tariff, the stranded cost charge was included in Entergy's transmission rate. See id. at 175-77.

[Page 49] Characterizing the stranded cost provision as a "tying arrangement" under antitrust law, Cajun explained that under the tariff, Entergy could charge a former customer for the cost of generation services when the customer wished to purchase only transmission services; because Entergy has a monopoly over transmission, customers would have no choice but to pay costs relating to generation they no longer wanted from Entergy. Id. at 177-78. Thus, because "Entergy could use its monopoly over transmission services to eliminate competition in the market for generation services," the net effect of the tariffs may be anticompetitive. Id. at 176.

Of significance to this case, however, we did not strike down the tariffs. Instead, we remanded the case for FERC to determine "how much competition in fact is dampened" by the stranded cost provision. Id. at 178. Thus, contrary to POSCR's suggestion, Cajun does not represent a blanket condemnation of stranded cost recovery; rather, recognizing that such recovery could be anticompetitive, Cajun directed FERC to evaluate and justify the potential anticompetitive impact. This is precisely what FERC has done in Order 888. It expressly considered the anticompetitive effects of stranded cost recovery. See Order 888-A, ¶ 31,048 at

30,372-74. Then, stressing the transitional nature of the recovery and the fact that recovery was compelled by the open access requirement, which utilities could not have anticipated, FERC concluded that the limited anticompetitive effects of stranded cost recovery were both a necessary and acceptable consequence of the transition to competition. See id. Not only has POSCR offered no evidence that would lead us to question FERC's conclusion, but such judgments about anticompetitive effects are "the kind of reasonable agency prediction about the future impact of its own regulatory policies to which we ordinarily defer." Louisiana Energy and Power Auth. v. FERC, 141 F.3d 364, 370 (D.C. Cir. 1999).

2. Natural Gas Precedent and Conformance to Cost Causation Principles

Having rejected POSCR's arguments that FERC lacks authority to authorize stranded cost recovery, we turn to its [Page 50]argument that FERC has failed adequately to explain why Order 888 requires departing customers to pay one-hundred percent of stranded costs. In support of this argument, POSCR claims that our decisions reviewing FERC's restructuring of the natural gas industry require cost sharing; it also argues that Order 888's stranded cost recovery conflicts with the cost causation principles that traditionally govern allocation of costs.

a. Natural gas precedent: AGD, K N Energy, and UDC

In introducing competition into the electricity industry, FERC has taken essentially the same path that it took in restructuring the natural gas industry, although what FERC has done in a single order in the electricity industry (Order 888) it did in a series of orders in the natural gas industry. Because POSCR relies so heavily on FERC's natural gas orders and our decisions reviewing them, we begin by summarizing them in some detail.

Finding practices in the natural gas industry "unduly discriminatory" in violation of the Natural Gas Act, FERC

began by issuing Order 436, which "unbundled" pipeline transportation and merchant functions. Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 436, FERC Stats. & Regs, ¶ 30,665, 50 Fed. Reg. 42,408 (1985) (rehearing orders omitted). At the time of Order 436, pipelines were facing enormous liabilities under long-term "take-or-pay" contracts. Entered into when gas prices were expected to rise, these contracts obligated pipelines to purchase minimum quantities of gas from wellhead producers at fixed prices that turned out to be well in excess of market prices. See Associated Gas Distributors v. FERC, 824 F.2d 981, 1021 (D.C. Cir. 1987) ("AGD"). Although FERC estimated take-or-pay liabilities at billions of dollars, and although Order 436 would exacerbate the take-or-pay problem by providing incentives to pipeline customers to purchase gas from cheaper suppliers, FERC declined to take any action with respect to the contracts. In AGD, we found that FERC's decision to do nothing failed to meet the requirements of reasoned decisionmaking, citing FERC's "seeming [Page 51] blindness to the possible impact of Order No. 436 on take-or-pay liability" and permanent market distortions that may result from FERC's inaction. Id. at 1021-23, 1025. Specifically, we noted, in words echoed by FERC years later in Order 888, that consumers who purchased from the "least nimble" local distribution companies would "be stuck with the burden of the overpriced gas." Id. at 1023.

In response to AGD, FERC issued Order 500, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 500, FERC Stats. & Regs. ¶ 30,761, 52 Fed. Reg. 30,334 (1987) (rehearing orders omitted). Recognizing that no one segment of the gas industry was wholly responsible for the take-or-pay problem, Order 500 allowed pipelines to recover take-or-pay costs through "equitable sharing." Pipelines that willingly absorbed twenty-five to fifty percent of their costs could require sales customers to match that amount through a fixed charge.

Pipelines could recover any balance through commodity rates or volumetric surcharges, borne by both sales and transportation customers. For an overview of these components of Order 500, see KN Energy, Inc. v. FERC, 968 F.2d 1295, 1297-98 (D.C. Cir. 1992). We sustained this approach in KN Energy, holding that even though Order 500 replaced traditional "cost causation" principles with cost spreading and value-of-service concepts, it did not violate Natural Gas Act section 4's requirement that rates be just and reasonable. Id. at 1301-02. Citing statements in AGD that "all actors in the natural gas industry" are "candidates" for absorbing take-or-pay liability, we relied on "the unusual circumstances surrounding the take-or-pay problem, and the limited nature—both in time and scope—of the Commission's departure from the cost-causation principle." Id. at 1301.

Concluding that Order 436 had been only partially successful in introducing competition into the natural gas industry, FERC issued its third major restructuring order, Order 636. Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 636, FERC Stats. & Regs. ¶ 30,939, 57 Fed. [Page 52] Reg. 13,267 (1992) (rehearing orders omitted). That order imposed mandatory unbundling of sales and transportation services and allowed sales customers to reduce the amount of gas they had to purchase pursuant to existing contracts. When customers took advantage of this option and purchased gas from sources other than the pipelines, the pipelines were once again left with substantial take-or-pay liabilities. Labeling the costs of reducing these liabilities gas supply realignment or GSR costs, Order 636 authorized pipelines to bill current transportation customers for one hundred percent of their GSR costs by charging either a negotiated exit fee or reservation fee surcharge. Order 636 also authorized pipelines to recover all stranded costs in rate filings. In the

natural gas industry, stranded costs represented the costs of pipeline assets (such as storage facilities) used to provide bundled sales services that were not directly assignable to transportation customers. For an overview of these components of Order 636, see United Distribution Cos. v. FERC, 88 F.3d 1105, 1125-27, 1176-78 (D.C. Cir. 1996) ("UDC").

In UDC, we affirmed FERC's determination that pipelines could recover all stranded costs through filed rates, so long as FERC "adequately balanced the interests of investors and ratepayers." Id. at 1180. Reaffirming the appropriateness of the cost spreading and value-of-service principles approved in K N Energy, we found that FERC's allocation of GSR costs to pipeline transportation customers, as opposed to the pipelines themselves, properly applied those principles. Id. at 1182. Although recognizing that GSR costs stemmed from pipeline sales customers, not transportation customers, we found that FERC appropriately imposed the costs on transportation customers because these customers benefited from the availability of lower-priced transportation and also because FERC could not spread costs to the pre-Order 636 sales customers since those customers no longer purchased gas from the pipelines. Id. at 1185-86. We remanded for FERC to explain more fully why pipelines should not have to pay some of the costs, noting an inconsistency in the Commission's analysis: While FERC applied cost spreading principles to justify imposing costs on transportation customers, it [Page 53]invoked cost causation principles in concluding that pipelines should not have to pay any of these costs. Id. at 1188-90. We explicitly stated, however, that we were not saying that "it is impossible, or even improbable, that the Commission on remand can establish a convincing rationale for exempting the pipelines." Id. at 1189.

POSCR reads this history to require FERC to order cost sharing, but it ignores Order 888's explanation of the

difference between natural gas restructuring and the situation in the electricity industry. Most fundamentally, Order 888 explains, stranded cost recovery in the electricity industry conforms to cost causation principles, which normally govern the allocation of costs and require customers to pay the costs they caused. See Order 888, ¶ 31,036 at 31,798. Cost causation principles could not be applied in natural gas restructuring, Order 888 explains, because many customers had already begun purchasing gas from other suppliers before FERC bad addressed the take-or-pay problem on remand from AGD, and because the filed rate doctrine prohibits assessing charges against former customers. Id. at 31,800-01. Order 888 also explains that unlike stranded costs in the electricity industry, the take-or-pay liabilities in the gas industry were extraordinary. The billions of dollars of take-or-pay liabilities resulted not from Order 636, but from earlier regulatory policies that had encouraged pipelines to enter into long-term, fixed-price gas purchase contracts, combined with declining gas prices that made those contracts uneconomical. See Order 888-A, ¶ 31,048 at 30,380. Under all of these circumstances, "[t]o have allocated these costs solely to any one segment of the industry would have imposed a crushing new burden on that segment." Id. at 30,380-81.

Stranded costs in the electricity industry, Order 888 explains, are quite different. Resulting directly from Order 888, they represent "ordinary costs that have always been, and are currently, included in the utility's rates for electric generation approved by the Commission." Id. at 30,382. Moreover, wholesale customers may avoid stranded cost liability by continuing to purchase power from their historic utility, precisely what they probably would have done in the [Page 54] absence of Order 888. In other words, in contrast to the natural gas industry, where customers would have faced enormous new burdens had FERC forced them to pay take-or-pay costs, customers in the electricity industry face no new burdens; instead, Order 888 requires them to pay

nothing more than costs they would have had to pay in the absence of Order 888. In the electricity industry, the only effect of stranded cost recovery is delayed realization of the full benefits of a competitive market.

In light of these differences between the natural gas and electricity industries and FERC's exhaustive treatment of the natural gas restructuring in Order 888, POSCR's contention that FERC has failed "to offer a coherent rationale, rising to the level of reasoned decisionmaking" for not imposing cost sharing is wholly without merit. Equally without merit is POSCR's assertion that UDC "teaches that, were customers and utilities benefit from an open access rule/order that leads to early contract termination and where anticompetitive conduct by utilities has given rise to the need for the open access order, utilities must share transition costs." POSCR ignores three important points. First, FERC, not this court, determined that cost sharing was appropriate with respect to take-or-pay liabilities. UDC merely affirmed FERC's decision. Second, KN Energy recognized that cost sharing in the natural gas industry was a departure from the cost causation principles that normally apply, a departure justified by extraordinary circumstances in the natural gas industry. KN Energy, 968 F.2d at 1301-02. And finally, as to stranded costs that more closely resemble those at issue in this case—for example, pipeline assets that would no longer be fully employed when customers took advantage of unbundling to purchase gas from alternative suppliers—FERC ordered and UDC affirmed, that pipelines recover one-hundred percent of those costs.

b. Conformance to cost causation principles

Having established that the natural gas cases impose no obligation on FERC to order cost sharing, we next consider POSCR's argument, that the inclusion of stranded costs in [Page 55] transmission rates does not conform to cost causation principles. This is so, POSCR asserts, because Order 888's stranded cost provisions require customers to

pay through transmission rates for costs the utility previously incurred to provide generation services.

As an initial matter, we note that payment through transmission rates is only one of three ways that a departing customer may pay its stranded cost obligation; the customer also has the option of making a lump-sum payment or installment payments. Thus POSCR's challenge seems aimed only at the method of payment, not at the fact that payment is required. But even viewing POSCR's challenge more broadly, as a claim that stranded cost recovery no matter what the method of payment violates cost causation principles, we think it lacks merit.

We have explained the cost causation principle as follows: "Simply put, it has been traditionally required that all approved rates reflect to some degree the costs actually caused by the customer who must pay them." KN Energy, 968 F.2d at 1300. Given this definition, we are puzzled by POSCR's claim that because inclusion of stranded costs in transmission rates requires customers to pay currently for costs incurred in the past, it violates cost causation principles. To some degree, all utility rates reflect past costs; utilities typically expend funds today (for example, constructing generation facilities), fully expecting to recover those costs through future rates. In fact, current rates often include past costs that utilities deferred in order to avoid rate increases. Cost causation requires not that costs be incurred at the same time they are included in rates, but that the rates "reflect to some degree the costs actually caused by the customer who must pay them." Id.

In fashioning Order 888's stranded cost recovery provisions, FERC went to great lengths to ensure that customers would be responsible for only those costs they caused.

> [T]he Rule is consistent with the traditional cost causation principle because it recognizes the link

> between the incurrence of the stranded costs and the decision of a [Page 56]particular generation customer to use open-access transmission on the utility's system to leave the utility's generation system and shop for power, and bases the utility's ability to recover stranded costs on its ability to demonstrate that it incurred costs with the reasonable expectation that the customer would remain on its generation system beyond the term of the contract.

Order 888-A, ¶ 31,048 at 30,382.

We cannot see how including stranded costs in transmission rates instead of lump sum payments changes this analysis. To the extent POSCR is arguing that including in a transmission rate costs incurred to provide generation services violates cost causation principles, we reiterate that stranded costs are not costs of providing the physical transmission services but, as Order 888-A explains, they are utilities' cost of open access transmission. See Order 888-A, ¶ 31,048 at 30,389 & n.634. More generally, given the fundamental changes wrought by Order 888 and the unprecedented opportunity for customers to purchase power from alternative suppliers, we are quite comfortable deferring to FERC's judgment that stranded cost recovery—through transmission rates or otherwise—conforms to cost causation principles. In fact, FERC may have violated cost causation principles had it failed to assign stranded costs to customers who caused them.

POSCR next argues that Order 888 is unduly discriminatory because including stranded costs in transmission rates forces transmission customers who previously used a utility's generation capacity to pay higher costs than new transmission customers. Disagreeing, FERC determined that requiring customers receiving similar services to pay different rates is necessitated by Order 888's open access requirement. See Order 888-A, ¶ 31,048 at

30,388-90. Cf. AGD, 824 F.2d at 1009 ("[T]he mere fact of a rate disparity is not enough to constitute unlawful discrimination.") (internal quotation marks omitted). Moreover, FERC concluded the application of cost causation principles justifies this different treatment. See Order 888-A, ¶ 31,048 at 30,379, 30,388-90. Seeing noth-[Page 57]ing unreasonable (let alone arbitrary or capricious) in FERC's policy judgment, we reject POSCR's challenge.

Nor do we agree with POSCR's argument that stranded cost recovery violates the filed rate doctrine, which "forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority." Western Resources, Inc. v. FERC, 72 F.3d 147, 149 (D.C. Cir. 1995). In Western Resources, we held that FERC's assignment to current customers of costs relating to take-or-pay liabilities did not violate the filed rate doctrine. Recognizing that "a central purpose of the doctrine is to enable purchasers to know in advance the consequences of the purchasing decisions they make," we determined that the doctrine was satisfied where customers received "adequate notice of a rate in advance of the service to which it relates." Id. at 149-50 (internal quotation marks omitted). Order 888's stranded cost policy satisfies this requirement because customers electing to purchase power generation from a source other than the transmitting utility from which they had purchased power in the past will be aware of the costs when making that decision.

3. FERC's Mobile-Sierra Findings

Under the Supreme Court's Mobile-Sierra doctrine, where parties have negotiated a contract that sets firm prices or dictates a specific method of computing charges and includes a clause denying either party the right to change such prices or charges unilaterally, "FERC may abrogate or modify the contract only if the public interest so requires." Texaco, Inc. v. FERC, 148 F.3d 1091, 1095 (D.C. Cir. 1998); see also FPC v. Sierra Pacific Power Co., 350 U.S. 348, 353-

55 (1956); United Gas Pipe Line Co. v. Mobile Gas Serv. Corp., 350 U.S. 332, 344-45 (1956). We have recognized that "the 'public interest' that permits FERC to modify private contracts is different from and more exacting than the 'public interest' that FERC seeks to serve when it promulgates its rules." Texaco, 148 F.3d at 1097.

FERC usually makes Mobile-Sierra determinations on a case-by-case basis. A party seeking to modify a contract [Page 58]containing a Mobile-Sierra clause petitions FERC. That party bears the burden of convincing FERC that the modification is in the public interest.

Order 888 departs from this normal case-by-case practice by making two generic public interest findings, one focused on utilities, the other on customers. These generic findings relieve utilities and customers of the burden of demonstrating in individual proceedings that the proposed modifications are in the public interest. As to utilities, Order 888 ruled that it was in the public interest to allow them to add stranded cost amendments to their contracts if they could demonstrate, in accordance with Order 888, that they had a reasonable expectation of continued service. See Order 888-A, ¶ 31,048 at 30,394-95. This finding rested on two considerations: that the burden of unrecoverable stranded costs could impair utilities' access to capital markets, which could in turn precipitate the departure of other customers, thus worsening the utilities' financial condition and threatening its ability to provide reliable service; and that allowing customers to leave a utility without paying their share of costs would shift those costs to other customers who lack alternative power sources. See Order 888, ¶ 31,036 at 31,811. For its second generic finding, FERC concluded that it was in the public interest to allow customers to modify their wholesale requirements contracts in any way upon a showing that the terms are no longer just and reasonable. See Order 888-A, ¶ 31,048 at 30,189. Observing that the contracts in question "were entered into during an era in

which transmission providers exercised monopoly control over access to their transmission facilities," FERC based this finding on the unequal bargaining power between utilities and customers. Id. at 30,193. Because "[m]any of these contracts were the result of uneven bargaining power between customers and monopolist transmission providers," FERC reasoned, "the unprecedented competitive changes that have occurred (and are continuing to occur) in the industry may render their contracts to be no longer in the public interest or just and reasonable." Id.

Challenging the first finding, POSCR argues that FERC lacks authority to make a generic public interest finding that [Page 59]allows for contract modification in an entire class of cases. POSCR insists that FERC can only proceed on a case-by-case basis, determining in each case whether a particular contract modification is in the public interest. Even if FERC has authority to make generic findings, POSCR goes on to argue, FERC's Order 888 finding is unsupported by substantial evidence. The investor owned utilities ("IOUs") challenge the second finding, arguing that allowing customers to seek modification of all contract terms, while limiting utilities to stranded cost provisions, fails adequately to balance competing interests.

a. FERC's authority to make a generic public interest finding

POSCR correctly observes that FERC has pointed to no case in which a court affirmed a generic Mobile-Sierra finding. At the same time, POSCR has cited no case prohibiting FERC from making a generic finding, nor have we found one. In the absence of definitive authority in either direction, and given the unique circumstances of this case and our traditional deference to FERC's expertise, we find no fault with FERC's generic determination.

The Mobile-Sierra doctrine "represents the Supreme Court's attempt to strike a balance between private

contractual rights and the regulatory power to modify contracts when necessary to protect the public interest." Northeast Utilities Serv. Co. v. FERC, 55 F.3d 686, 689 (1st Cir. 1995). In Mobile, the Supreme Court recognized that intervening circumstances may create a situation in which contractual terms and conditions that were just and reasonable at the time the contract was executed are no longer just and reasonable. 350 U.S. at 344-45. But concluding that a utility is not typically "entitled to be relieved of its improvident bargain," the Sierra Court required that FERC's predecessor, the Federal Power Commission, show more than that the contract was unjust and unreasonable—the Commission had to find that contract modification was in the public interest. 350 U.S. at 355.

In most cases, intervening circumstances are unique to the relationship between contracting parties. See, e.g., Northeast [Page 60] Utilities, 55 F.3d 686 (affirming FERC's modification to the rate schedule of a contract as a condition for approval of a merger between two parties to the contract). But where intervening circumstances—in this instance, FERC—mandated open access transmission—affect an entire class of contracts in an identical manner, we find nothing in the Mobile-Sierra doctrine to prohibit FERC from responding with a public interest finding applicable to all contracts of that class. Moreover, in providing for stranded cost recovery, FERC has not relieved utilities of "improvident bargains," the concern of the Sierra Court; rather, it has recognized that open access affects all utilities in the same manner, namely leaving them vulnerable to potentially unrecoverable stranded costs. In fact, to deny FERC authority to make generic findings in such a case would simply impose on it and the parties the repetitive burden of proving the public interest in each and every case.

In sustaining FERC's generic finding, we are influenced by the fact that before recovering stranded costs, a utility must prove that it had a reasonable expectation of continued

service to a particular customer. As the IOUs intervening on behalf of FERC explain, the need to make this showing adds a particularized element to FERC's generic public interest finding. Viewed this way, Order 888's generic finding is more precisely stated as follows: It is in the public interest to allow utilities to recover stranded costs if they can prove that they had a reasonable expectation of continued service to particular customers. If a utility can demonstrate that it had a reasonable expectation of continued service to a particular customer, and incurred costs based on that expectation, then it would be against the public interest to require other customers or shareholders to bear those costs. As Order 888 explains, "the case-by-case findings that some commenters seek will, in effect, be made when the Commission determines whether to approve a proposed stranded cost amendment to a particular contract." Order 888, ¶ 31,036 at 31,813.

We stress that generic Mobile-Sierra findings are appropriate only in rare circumstances. Order 888 is just such a circumstance. It fundamentally changes the regulatory envi-[Page 61]ronment in which utilities operate, introducing meaningful competition into an industry that since its inception has been highly regulated and affecting all utilities in a similar way.

b. FERC's stranded cost public interest finding

Having concluded that the Mobile-Sierra doctrine permits a generic finding in this case, we turn to POSCR's claim that the finding was unsupported by substantial evidence. POSCR faults FERC for failing to adduce evidence to support its conclusion that denying stranded cost recovery would put particular utilities in financial peril. POSCR also thinks that the impact on customers of failing to provide for stranded cost recovery is insufficient to support a public interest finding.

With respect to POSCR's first point, it is certainly true that Sierra identified impairment of "the financial ability of the public utility to continue its service" as one factor supporting a public interest finding. Sierra, 350 U. S. at 355. Relying on this, POSCR challenges FERC's public interest finding on the ground that the record contains no individual assessments of the financial condition of public utilities.

Although public interest findings made on a case-by-case basis necessarily evaluate the harm to the particular utility seeking modification, that is not true where, as here, FERC implements a generic change in the industry. Just as that change can support a generic public interest finding, that generic finding can be supported by generic industry-wide evidence. FERC has produced such evidence. The record contains estimates of stranded costs amounting to $200 billion or more. See Stranded Cost NOPR, ¶ 32,507 at 32,866. It also includes comments from representatives of the financial community stating that "the prospect of not recovering stranded costs could erode a utility's ability to attract capital."

POSCR points out that eighty-five to ninety percent of the estimated $200 billion of stranded costs relates to retail sales, not wholesale sales. True enough, but we find no basis for questioning FERC's conclusion that unrecovered stranded [Page 62] costs of even ten percent of 200 billion—the low end of the wholesale stranded cost estimate—could have serious consequences for utilities. See Order 888, ¶ 31,036 at 31,790. In any event, if POSCR turns out to be correct about the absence of a wholesale stranded cost problem, few utilities will avail themselves of Order 888's stranded cost recovery provisions.

POSCRs second argument focuses on FERC's finding that "if some customers are permitted to leave their suppliers without paying for stranded costs, this may cause an excessive burden on the remaining customers who, for whatever reason, cannot leave and therefore may have to bear

those costs." Order 888, ¶ 31,036 at 31,811. POSCR does not agree with FERC that the failure to recover stranded costs will create an "'undue burden" on remaining customers. But disagreeing with FERC is not enough. To prevail in this court, POSCR must demonstrate that FERC's prediction that failure to recover stranded costs will create an undue burden on remaining customers is unsupported by substantial evidence, see 16 U.S.C. § 8251(b), which is another way of saying it is arbitrary and capricious. See Michigan Consolidated Gas Co. v. FERC, 883 F.2d 117, 124 (D.C. Cir. 1989) ("[M]aking ... predictions is clearly within the Commission's expertise and will be upheld if rationally based on record evidence.") (internal quotation marks omitted). This POSCR has failed to do.

c. FERC's public interest finding regarding customers

The IOUs mount two challenges to FERC's second public interest finding—that it was in the public interest to allow customers to seek modification of their wholesale requirements contracts. Unlike POSCR, the IOUs make no claim that the finding lacks substantial evidence; rather, they contend that FERC's decision to allow customers to seek modification of all contract terms, while limiting utilities to adding stranded cost provisions, fails to balance FERC's competing concerns: respecting existing contractual commitments and accelerating the transition to competition. They also complain that FERC has failed adequately to explain [Page 63] why affording customers this broad ability to modify their contracts is in the public interest.

FERC gave two justifications for affording customers a broader opportunity than utilities to modify their contracts, both of which seem perfectly rational to us. First, Order 888-A explains, "these contracts were entered into during an era in which transmission providers exercised monopoly control over access to their transmission facilities." Order 888-A, ¶ 31,048 at 30,193. Also, the "unprecedented competitive changes ... may affect whether such contracts continue to be

just and reasonable or not unduly discriminatory both as to the direct customers of the contracts, as well as to indirect, third-party consumers...." Id. at 30,193-94. In fact, Order 888 rests on the very premise that by denying competitors access to their transmission lines, utilities engaged in undue discrimination. Confined to purchasing power from their local utilities, customers suffered from this lack of access. In the natural gas restructuring, we affirmed FERC's decision to allow customers to seek to modify their sales contracts because those contracts "necessarily reflect the pipelines' monopoly power." AGD, 824 F.2d at 1017. The same reasons call for affirming FERC's decision here. In addition, as FERC has explained, the harm to third parties (i.e., customers of the wholesale requirements customers) that may result from adherence to uneconomical contracts further justifies its conclusion. See Order 888-A, ¶ 31,048 at 30,194. Remedying potential unfairness to utilities by allowing them to seek stranded cost recovery if a customer shortens the term of a contract, FERC struck a balance between customers and utilities that can hardly be characterized as arbitrary or capricious.

4. Availability of Stranded Cost Recovery to Nonjurisdictional Utilities and G&T Cooperatives

Section 201 of the FPA gives FERC jurisdiction over "public utilities" but not over federal and state utilities. 16 U.S.C. § 824. Although FERC required utilities not subject to its jurisdiction ("nonjurisdictional utilities") to provide reciprocal open access transmission when they use a jurisdic-[Page 64]tional utility's open access tariff, it declined to provide a mechanism for them to recover stranded costs, Explaining that it promulgated its reciprocity provision pursuant to fairness concerns, not statutory authority, FERC reasoned that it lacked jurisdiction to provide stranded cost recovery for nonjurisdictional utilities. See Order 888-A, ¶ 31,048 at 30,364. FERC recommended that these utilities include stranded cost provisions in their open access tariffs;

those tariffs would be reviewed not by FERC but by the appropriate regulatory authority. See id.

Dairyland petitioners contend that FERC acted arbitrarily and capriciously in denying nonjurisdictional utilities stranded cost recovery, arguing that the same "fairness" concerns invoked by FERC to require reciprocal open access transmission require the award of stranded costs. To be sure, FERC may have had authority to include stranded cost recovery as a provision of Dairyland's open access tariff. But Dairyland has offered no reason for thinking that FERC's refusal to do so was arbitrary and capricious. Given the limited scope of FERC's stranded cost provisions, its lack of jurisdiction over entities like Dairyland, and the ability of nonjurisdictional utilities to include stranded cost provisions in their open access tariffs, we see no reason to question FERC's judgment on this issue.

The same is true with respect to the transmission dependent utilities ("TDUs"). Like the Dairyland petitioners, they claim that FERC acted arbitrarily and capriciously by failing to provide a mechanism for them to recover stranded costs. Owning few or no transmission facilities, TDUs serve their loads using other utilities' transmission systems. Not only are TDUs nonjurisdictional utilities, but, as Order 888-A explains, open access does not cause their costs to become stranded—their customers have always had an option to use other utilities' transmission services to purchase power. See Order 888-A, ¶ 31,048 at 30,365.

Dairyland also contends that FERC acted arbitrarily and capriciously when it declined to treat a generation and transmission ("G&T") cooperative and its member distribution [Page 65] cooperatives as a single economic unit for stranded cost purposes. G&T cooperatives provide bundled wholesale power to their member distribution cooperatives, who in turn sell the power to the members' retail customers. Observing that cooperatives, unlike traditional utilities, are not vertically integrated but instead

function as single economic units, Dairyland claims that G&T cooperatives have reasonable expectations of continued service to retail customers of their member cooperatives that differ substantially from the expectations public utilities have with respect to retail customers of their wholesale customers. This difference, Dairyland argues, requires FERC to allow G&T cooperatives to recover stranded costs from their member cooperatives' customers.

Rejecting Dairyland's petition for rehearing on this point, FERC noted that treating a G&T cooperative and its members as a single economic unit for purposes of stranded cost recovery would conflict with its treatment of these same cooperatives as distinct entities in its reciprocity provisions. Order 888-A, ¶ 31,048 at 30,366. There, FERC agreed with Dairyland's proposal that if a G&T cooperative seeks open access transmission from a public utility, "then only the G&T cooperative, and not its member distribution cooperatives, would be required to offer [reciprocal] transmission service." Order 888, ¶ 31,036 at 31,763. Moreover, FERC reasoned, recovering from a retail customer of a member cooperative is, in effect, recovering from an indirect customer, a situation that FERC declined to include in its stranded cost rule. See Order 888-A, ¶ 31,048 at 30,166.

It is true that FERC could have treated G&T cooperatives and their members as single economic units for stranded cost purposes. But FERC's explanation of why it chose not to do so, particularly the fact that G&T cooperatives and their members were treated is distinct entities for reciprocity purposes, is entirely reasonable.

5. Challenges to Technical Aspects of Order 888's Stranded Cost Recovery Provisions

Several petitioners mount challenges to various technical aspects of the stranded cost recovery provisions. Before [Page 66] addressing these challenges, we emphasize the very limited scope of our review. For us to undo what FERC

has done, petitioners must persuade us that FERC's actions were arbitrary or capricious. "Highly deferential," the arbitrary and capricious standard "presumes the validity of agency action." National Mining Ass'n. v. Mine Safety and Health Admin., 116 F.3d 520, 536 (1997). Where, as here, the issue before us "requires a high level of technical expertise, we must defer to the informed discretion of the responsible federal agencies." Marsh v. Oregon Natural Resources Council, 490 U.S. 360, 377 (1989) (internal quotation marks omitted). It is not enough for petitioners to convince us of the reasonableness of their views, see UDC, 88 F.3d at 1169 ("The existence of a second reasonable course of action does not invalidate an agency's determination."); those arguments should be presented to FERC, whose commissioners are appointed by the President and confirmed by the Senate with the expectation that they, not Article III courts, will make policy judgments.

To prevail in this court, petitioners must demonstrate that FERC's policy judgments are arbitrary or capricious, a heavy burden indeed. See National Treasury Employees Union v. Hefler, 53 F.3d 1289, 1292 (D.C. Cir. 1995) ("The 'scope' of review under the "arbitrary and capricious" standard is narrow and a court is not to substitute its judgment for that of the agency.") (quoting Motor Vehicles Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983.)). With this very deferential scope of review in mind, we turn to petitioners' arguments.

a. POSCR's challenges to the stranded cost formula

Reasoning that it would be burdensome to identify each and every asset that would become underutilized as a result of Order 888, FERC adopted a "revenues lost" formula to determine a departing customer's stranded cost obligation. Order 888, ¶ 31,036 at 31,839. For each year a utility can prove that it had a reasonable expectation of continued service to a particular customer, the formula calculates the customer's stranded cost obligation by subtracting the com-

[Page 67]petitive market value of the power the customer would have purchased from the utility (as estimated by the utility) from the amount the customer would have paid had it remained a generation customer of the utility (based on FERC-approved rates that the customer paid the prior three years). Id. at 31,839-40.

POSCR claims that this formula gives utilities no incentive to mitigate their stranded costs. Not so. The formula automatically provides such an incentive by subtracting from utilities' recovery the market price of the power—utilities that fail to sell the power at market prices will not recover their full costs. POSCR also claims that the formula fails accurately to measure stranded costs because it is based on an estimate of those costs at one point in time. Responding, FERC explained why it rejected a "true-up" provision that would have made adjustments to the amount the customer owed to reflect market conditions over the reasonable expectation period. According to FERC, such an approach would have created enormous uncertainty, outweighing any potential increase in accuracy. See Order 888-A, ¶ 31,048 at 30,427-28. POSCR has offered no basis for us to question this reasoning.

POSCR's claim that the formula gives utilities an incentive to minimize their estimate of the market value of the power the customer would have purchased is similarly groundless. To avoid precisely this result, Order 888 gives customers an option to either market or broker the capacity and associated energy they would have purchased from their historic utility, effectively reducing their stranded cost obligations by the difference between the actual market value of the power and the utility's estimate of the market value. See Order 888, ¶ 31,036 at 31,844. Order 888 also gives customers an option to substitute the price of power under the customer's contract with a new supplier for the utility's estimate of the market value. See id.

One final point. Throughout its brief and at oral argument, POSCR consistently referred to stranded costs as "imprudently incurred costs." Although it never developed this [Page 68] argument, we think it worth noting that all costs included in customers' stranded cost obligations are based on FERC-approved rates and were included in utility rate bases as assignable to particular customers. To us, this means that these costs are legitimate, prudent, and verifiable.

b. Inclusion of known and measurable costs

The IOUs take issue with Order 888's stranded cost recovery formula because the estimate of the price the customer would have paid for the power is based on rates for the prior three years; according to the IOUs, this approach fails to consider known and measurable costs resulting from regulatory mandates that may have been deferred pursuant to filed rate schedules and FERC-approved settlements. The costs they cite include deferred costs of generation that have already been approved for inclusion in the rate base, costs relating to approved qualifying facility contracts, and government-imposed costs such as deferred taxes and nuclear decommissioning.

Although it is true that the revenue calculation measures only current rates and not deferred costs, Order 888 allows customers and utilities to file for a change in the rates before the customer's requirements contract terminates; in such cases, FERC will calculate the customer's stranded cost obligation based on those new rates. See Order 888-A, ¶ N31,048 at 30,427. While seeking to avoid detailed listings of specific costs that may become stranded, FERC has adequately preserved utilities' ability to include known, measurable costs in revenue estimates through a ratemaking proceeding.

c. Treatment of energy costs in the market option

The IOUs challenge FERC's treatment of energy costs in the market option. To mitigate utilities' incentives to

minimize their estimates of the market value of the power (the competitive market value estimate or "CMVE"), Order 888 affords customers an option to buy the power stranded by their departure from the utility and resell it. Order 888, ¶ 31,036 at 31,844. Customers would purchase generation [Page 69] capacity at the utility's estimated market value of the capacity and associated energy at average system variable cost. Id. at 31,845. Thus if a customer believes that a utility is underestimating the price at which it could sell the power, the customer can buy the power and then resell it. While customers exercising this option would still have to pay their stranded cost obligation as calculated under the formula, they would effectively offset the obligation by keeping the profit on the resale of the power. Id. at 31,845 n.879.

The IOUs contend that allowing customers to pay average variable cost for the associated energy is inconsistent with Order 888's definition of the CMVE, which equals the market value of both the generation capacity and associated energy. See id. at 31,839 (defining CMVE as "the utility's estimate of the average annual revenues ... that it can receive by selling the released capacity and associated energy, based on a market analysis performed by the utility"). Customers could receive a windfall, the IOUs claim, by exercising the market option although they will pay average variable cost for the associated energy, they will be able to resell it at the presumably higher market price. At the same time, utilities will be unable to recover the full market value of the power because they will be forced to sell the associated energy at cost.

Responding to this argument in Order 888-A, FERC offered two justifications for allowing customers to purchase the associated energy at average variable cost. First, because the capacity being marketed would not generally be associated with a single asset, customers exercising this option are purchasing a "slice of the system" and thus should pay average variable cost. Second, customers should be able

to purchase energy at the price they currently pay, typically average variable cost. See Order 888-A, ¶ 31,048 at 30,433. But neither explanation responds to the IOUs argument that defining CMVE as the market price of both the capacity and associated energy is inconsistent with allowing customers exercising the market option to purchase associated energy at average variable cost. In its brief in this court, FERC continues to misapprehend the IOUs' argument, largely reit- [Page 70] erating the same arguments and failing to address the inconsistency.

The market option's stated intention is to reduce a utility's incentive to understate the CMVE. See Order 888, ¶ 31,036 at 31,842. If it did understate the CMVE, then customers could buy the power from the utility and resell it, keeping the difference. But FERC's policy of allowing customers to purchase the associated energy at cost gives customers an incentive to exercise the market option even when a utility has appropriately estimated CMVE because they can buy the energy at cost and resell it at the presumably higher market price. FERC's failure to explain whether it intended this result and if so, the justification for permitting customers to receive a windfall while undercompensating utilities constitutes a failure of reasoned decisionmaking. See AGD, 824 F.2d at 1030 ("We do not require that FERC reach any particular conclusion; we merely mandate that it reach its conclusion by reasoned decisionmaking."). We therefore vacate this portion of the orders and remand the issue to FERC for further consideration.

d. Rescission of notice of termination provision

Until FERC issued Orders 888 and 889, it had required parties to power sales contracts to notify it sixty days prior to cancellation of a contract or termination of a contract by its own terms. See 18 C.F.R. § 35.15 (repealed by Order 888). Orders 888 and 889 eliminate the requirement that parties notify FERC in advance when a contract terminates by its own terms, but only with respect to contracts executed after

July 9, 1996; in other cases of contract cancellation or termination, parties must still notify FERC in advance. See 18 C.F.R. § 35.15 (1999). TDU petitioners claim that in rescinding the notice requirement, FERC ignored the fact that utilities still have substantial market power. That some utilities retain market power in generation, however, does not undermine Orders 888 and 889. Through these orders, FERC sought to move the electricity industry toward competition; by providing an open access mechanism through which buyers may purchase power from suppliers other than trans-[Page 71]mitting utilities, FERC substantially reduced. Utilities' market power. Eliminating the notice requirement furthered that policy. Moreover, customers who believe termination of their contracts is unjust can seek relief from FERC pursuant to section 206 of the FPA; See Order 888-A, ¶ 31,048 at 30,393.

e. Provision for benefits lost

The TDU petitioners claim that FERC acted arbitrarily and capriciously by failing to provide a mechanism for customers purchasing power at below-market rates to preserve those rates at the termination of their contract with their historic utility. Just as utilities may have expectations of continued service to particular customers, the TDU petitioners contend, customers may have reasonable expectations of continuing to receive wholesale requirements service from their historic utility at cost-based rates. Order 888-A says that the Commission does "not have a sufficient basis on which to make generic findings that customers under such contracts may be entitled to extend a contract at the existing rate." Order 888-A, ¶ 31,048 at 30,393 (emphasis removed). Moreover, the order explains, "the consequences of customers' expectations as a general matter would not have the potential to shift significant costs to other customers," whereas utilities' failure to recover stranded costs could potentially shift the costs to other customers. Id.

We think that FERC has adequately explained why it chose not to provide for benefits-lost recovery in Order 888. Most important, FERC has not foreclosed customers in this situation from seeking relief As Order 888-A explains, a customer may "exercise its procedural rights under section 206 to show that the contract should be extended at the existing contract rate, or [ ] make such a showing in the context of a utility's proposed termination of a contract pursuant to the section 35.15 notice of termination (approval) requirement." Id. (footnote omitted). Given that agencies "enjoy[ ] broad discretion in determining how best to handle related, yet discrete, issues in terms of procedures ... and priorities," we think FERC's refusal to promulgate a generic rule on this issue was entirely reasonable. Mobil Oil Explo-[Page 72]ration & Producing Southeast, Inc. v. United Distrib. Cos., 498 U.S. 211, 230 (1990).

B. Retail Stranded Costs

Recognizing state agency authority to address stranded costs that relate to retail power sales, Order 888 limits FERC's role as a forum for the recovery of these costs to two situations: when customers take advantage of state-ordered wheeling to reach new power suppliers and when former retail customers become wholesale customers through what is known as municipalization or municipal annexation. See Order 888-A, ¶ 31,048 at 30,402, 30,410. In the former scenario, FERC will consider proposals for the recovery of stranded costs only when the appropriate state regulatory commission lacks authority to do so; in the latter situation, FERC will serve as the primary forum for resolution of stranded cost claims.

1. Stranded Costs Arising from Retail Wheeling

Stranded costs may result from state unbundling of retail sales, where retail customers take advantage of state-ordered retail wheeling to reach new generation suppliers. See Order 888, ¶ 31,036 at 31,819. Observing that both FERC and the

states have authority to address these stranded costs, Order 888 explains that:

> [B]ecause it is a state decision to permit or require the retail wheeling that causes retail stranded costs to occur, we will leave it to state regulatory authorities to deal with any stranded costs occasioned by retail wheeling. The only circumstance in which we will entertain requests to recover stranded costs caused by retail wheeling is when the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required.

Order 888, ¶ 31,036 at 31,824-25 (footnote omitted). FERC will provide for recovery of those stranded costs through the transmission rate the former supplying utility charges the departing customer. Order 888-A, ¶ 31,048 at 30,410. (As discussed in Section III supra, FERC has jurisdiction over [Page 73]the transmission component of unbundled retail sales.). In evaluating claims for stranded cost recovery, FERC will use the same standards as it applies with respect to wholesale stranded costs (i.e., it will require utilities to demonstrate a reasonable expectation of continued service). See Order 888, ¶ 31,036 at 31,819 n.722.

Two sets of petitioners challenge FERC's retail stranded cost recovery provisions from opposite sides. The States and POSCR contend that FERC exceeded its jurisdiction by asserting rate authority over retail stranded costs. The IOUs argue that FERC abdicated its statutory authority by failing to agree to consider all proposals for recovery of stranded costs that arise from retail wheeling. Because we think FERC has appropriately exercised its jurisdiction, we reject both claims.

a. FERC's jurisdiction over retail stranded costs

The States' and POSCR's arguments boil down to the following: Because retail stranded costs relate primarily to

facilities used for retail generation, and because section 201(b) of the FPA explicitly excludes these facilities from FERC's jurisdiction, FERC may not provide for recovery of these costs in FERC-jurisdictional rates. Unbundling electricity sales, they argue, cannot alter the jurisdictional status of these costs.

As an initial matter, we agree with FERC that petitioners confuse costs and rates. Rates are jurisdictional; costs are not. As Order 888-A explains:

> [T]here are rarely separate retail and wholesale generating facilities. Retail customers and wholesale requirements customers get energy from the same facilities, each buying a "slice of the system." Typically all generating assets go into both the retail and the wholesale rate bases for determining retail and wholesale rates. Rates are determined by allocating the total generating costs among customer classes. The parties confuse the issue before us to the extent they suggest that state commissions, not this Commission, have "jurisdiction" over cer-[Page 74]tain "costs." Neither the state commissions nor this Commission has exclusive jurisdiction over "costs." Each regulatory authority has jurisdiction to determine "rates" for services subject to its jurisdiction and, in determining rates, may take into account all of the costs incurred by the utility.

Order 888-A, ¶ 31,048 at 30,414. In other words, as FERC explained in its brief "regulatory authorities do not carve out so-called 'wholesale costs' that only FERC can take into account in determining rates subject to its jurisdiction or so-called 'retail costs' that only a state commission can take into account in determining rates subject to state jurisdiction." Instead, "[u]nder historical cost-of-service ratemaking, each regulatory authority, in exercising its respective ratemaking jurisdiction, reviews the total costs incurred by a utility to

provide service and makes its separate and independent determination of what costs may be recovered through rates within its jurisdiction." Order 888-A, ¶ 31,048 at 30,414.

Thus, while petitioners correctly point out that section 201(b) of the FPA denies FERC jurisdiction over "facilities used for the generation of electric energy," that provision does not necessarily prevent FERC from including costs relating to generating facilities in transmission rates, over which FERC indisputably has jurisdiction. 16 U.S.C. § 824(b). This is so because this part of section 201(b) is modified by the phrase "except as specifically provided in this subchapter and subchapter III of this chapter." Id. Given that section 201(a) grants FERC jurisdiction over "the transmission of electric energy in interstate commerce" and, therefore, over transmission rates, 16 U.S.C. § 824(a), FERC may exercise jurisdiction over generation facilities to the extent necessary to regulate interstate transmission.

This is exactly the construction that we gave section 201(b) in Mississippi Industries v. FERC, 808 F.2d 1525, 1543-45 (D.C. Cir. 1987) (subsequent history omitted). There, petitioners challenged FERC's authority to reallocate costs relating to generation facilities among utilities that were parties to a power sales agreement. Justifying its authority to reallo-[Page 75]cate such costs, FERC relied on its "undisputed jurisdiction over interstate sales of electric energy at wholesale." Id. at 1543. We agreed: "[A]lthough allocating cost does, to some extent, result in the 'regulation of matters relating to generation,' such regulation is valid under the FPA when it is the byproduct of a legitimate exercise of FERC's power to regulate wholesale rates." Id. In reaching this conclusion, we rejected petitioners' argument that "the statutory prohibition of federal regulation of [generation] facilities in section 201(b) becomes meaningless if FERC is permitted to allocate the costs of a plant," given FERC's undisputed responsibility to regulate the wholesale sale of power. Id. at 1543-44. Under Mississippi Industries,

then, FERC may regulate costs relating to generation facilities if such regulation "is the byproduct of a legitimate exercise of FERC's power to" regulate interstate transmission. Id. at 1543. Because FERC indisputably has jurisdiction over transmission rates, Mississippi Industries also disposes of Petitioners' argument that FERC's retail stranded cost recovery provisions run afoul of section 201(a) of the FPA, which provides that "Federal regulation [shall] extend only to those matters which are not subject to regulation by the States." 16 U.S.C. § 824(a).

Attempting to distinguish Mississippi Industries, petitioners point out that the case "involved authority to allocate generation costs to a wholesale sales rate (which may, of course, include generation costs)." True, but Mississippi Industries provides clear authority for the proposition that there is no per se jurisdictional bar to FERC's including generation costs in jurisdictional rates, whether wholesale sales rates or transmission rates. Thus narrowed, the question before us is this: Is inclusion of stranded costs relating to generation facilities in transmission rates the byproduct of a legitimate exercise of FERC's authority over transmission rates? In most cases the answer would be no, but given the highly unusual circumstances of this case, we think the answer is yes. Just as FERC may include generation-related wholesale stranded costs in transmission rates (see Section V.A.1.b), it may include generation-related retail stranded costs in transmission rates. That retail stranded costs were [Page 76]originally reflected in state-jurisdictional retail sales rates does not change the analysis, for in both cases the stranded costs can be viewed as "costs" of providing transmission services: "While such costs are not a cost of operating the physical transmission system, nevertheless, they are an economic cost incurred as a result of being required to provide retail transmission." Order 888-A, ¶ 31,048 at 30,414 n.708. While we agree that generation-related retail costs are not typically "costs" relating to transmission services, the fundamental changes

wrought by state-ordered retail wheeling, as well as the narrow circumstances in which FERC will consider stranded cost recovery claims, justify the conclusion that these costs are costs of providing transmission service.

Petitioners claim that by agreeing to consider retail stranded cost recovery claims, FERC has unduly interfered with state legislative processes and decisions. We disagree. FERC has limited its "interference" to instances where state commissions have no authority even to address stranded cost recovery claims. Describing its role as limited to "fill[ing] any regulatory gap," FERC made it clear that it will deny consideration to any utility seeking stranded cost recovery "if a state regulatory authority with authority to address retail wheeling stranded costs has in fact addressed such costs, regardless of whether the state regulatory authority has allowed full recovery, partial recovery, or no recovery." Order 888-A, ¶31,048 at 30,415. Under these circumstances, it can hardly be said that FERC has usurped state authority.

b. FERC's refusal to assert jurisdiction over all retail stranded costs.

Contending that FERC did not go far enough, the IOUs challenge the agency's refusal to consider claims for stranded costs resulting from state-ordered retail wheeling unless the relevant state regulatory commission lacks authority to address such claims. They claim that FERC should have agreed to consider proposals for retail stranded cost recovery whether or not the state commission had authority to address the claim, and even whether or not a state commission with such authority had already addressed the claim. In support [Page 77]of their position the IOUs advance three related arguments. They allege first that by concluding that it had jurisdiction over retail stranded costs but declining to exercise it, FERC abdicated its legal authority. Second, they say, FERC violated its statutory obligation to ensure just and reasonable rates. And finally, they contend that FERC erred

in concluding that stranded costs resulting from retail wheeling lack a direct nexus to the open access transmission ordered in Order 888.

With respect to their first argument, the IOUs claim that once FERC determined that it had jurisdiction over retail stranded costs, the agency had to exercise that jurisdiction. In making this argument, the IOUs make the same mistake POSCR made: They confuse FERC jurisdiction over costs with its jurisdiction over rates. FERC has not "concluded that it shares jurisdiction over retail stranded costs with the states," as the IOUs assert. As we explained above, "costs" are not jurisdictional. The FPA speaks not in terms of "costs," but in terms of "rates," requiring FERC to ensure that rates are just, reasonable, and not unduly discriminatory. FERC indisputably has jurisdiction over interstate transmission rates. In essence, then, the IOUs claim that FERC has no discretion to leave retail stranded cost recovery to state authorities.

We review claims that an agency lacks discretion to follow (or decline to follow) a certain course of action by examining the agency's governing statute as well as its own regulations. See, e.g., National Wildlife Federation v. Browner, 127 F.3d 1126, 1130 (D.C. Cir. 1997)(concluding that agency regulations do not require EPA to review and approve or disapprove a state's decision to maintain existing water quality standards); NRDC v. EPA, 25 F.3d 1063, 1069-70 (D.C. Cir. 1994) (holding that neither the governing statute nor relevant regulations impose a mandatory duty on EPA to list all wastes that exhibit a hazardous characteristic; statute gives EPA "substantial room to exercise its expertise in determining the appropriate grounds for listing"). The IOUs have failed to point to any statutory provision that robs FERC of discretion to decide, as a matter of policy, that state regulato-[Page 78]ry commissions should serve as the primary forum for retail stranded cost recovery. Our own examination of the FPA reveals no such provision either.

Sections of the statute giving FERC jurisdiction over transmission in interstate commerce, 16 U.S.C. § 824(a), and requiring FERC to ensure that rates are just and reasonable, 16 U.S.C. § 824d(a), do not alone create a mandatory duty to consider proposals for retail stranded cost recovery.

The two Supreme Court cases the IOUs rely on provide no support for their position, for in both cases the agencies, unlike FERC in this case, failed to comply with a specific statutory mandate. In MCI v. AT&T, 512 U.S. 218 (1994), the Supreme Court held that the FCC could not exempt certain communication common carriers from filing a tariff; the statute specified that all carriers must file tariffs. Similarly, in FPC v. Texaco, Inc., 417 U.S. 380 (1974), the Supreme Court determined that the FPC could not exempt certain producers from the statute's requirement that rates be just and reasonable. Under these cases, FERC would abdicate its statutory obligations if it, for example, exempted certain utilities from the requirement that rates be just and reasonable (as in Texaco), or if it refused to review transmission rate filings altogether. These cases do not hold that in carrying out its statutory obligations, FERC has no discretion to determine as a matter of policy that states are better positioned to address costs originally included in retail rate cases. What the IOUs suggest that because FERC has authority to address retail stranded costs through transmission rates, it must exercise that authority—is simply not the law.

As an alternative to their legal argument, the IOUs claim that FERC acted arbitrarily and capriciously in determining that just and reasonable transmission rates include retail stranded cost recovery in some circumstances but not in others. Their argument goes like this: Section 201(b)(1) of the FPA gives FERC exclusive jurisdiction over transmission of electric energy in interstate commerce. Under section 205, FERC must set just and reasonable rates. In addition, sections 205 and 206 prohibit undue discrimination. Thus,

[Page 79]the IOUs argue, "[b]y approving different transmission rates, some including stranded cost recovery (e.g., municipalization), and others without (e.g., retail wheeling or bypass), FERC is sanctioning arbitrary and capricious differences in violation of the FPA."

In making this argument, the IOUs ignore the wide discretion the FPA affords FERC to determine what constitute "just and reasonable rates" and "undue discrimination," as well as the unusual circumstances created by an industry change as fundamental as Order 888's open access requirement. Just because some transmission rates include retail stranded costs while others do not does not alone make Order 888 arbitrary and capricious; rather, petitioners must show that there is no reason for the difference. Cf. AGD, 824 F.2d at 1009 ("[T]he mere fact of a rate disparity is not enough to constitute unlawful discrimination.") (internal quotation marks omitted). We think FERC has provided a convincing explanation for the difference. "Recovery of this type of cost through a transmission rate is obviously not the norm," explains Order 888-A, "but is necessitated by the need to deal with the transition costs associated with this Rule." Order 888-A, ¶ 31,048 at 30,418. Only in situations where state regulatory commissions lack authority to award stranded costs will FERC include these costs in transmission rates. Otherwise, customers would be able to avoid their stranded cost obligations, leaving utility shareholders or remaining customers to bear the costs.

The IOUs reliance on the natural gas restructuring cases is misplaced. Setting aside the extraordinary nature of take-or-pay liabilities as compared to the stranded costs at issue here, AGD required only that FERC address the take-or-pay liabilities that the pipelines had incurred. See AGD, 824 F.2d at 1030 ("We do not require that FERC reach any particular conclusion; we merely mandate that it reach its conclusion by reasoned decisionmaking."). That is exactly

what Order 888 does with respect to stranded costs. While FERC has not agreed to serve as the forum for recovery of these costs in all situations, neither the FPA nor the natural gas cases requires it to do so. By ensuring that utilities have a forum in which [Page 80]to bring claims for retail stranded cost recovery, FERC has done just what AGD requires.

Nor do we find merit in the IOUs' argument that FERC erred in concluding that stranded costs resulting from retail wheeling lack a direct nexus to the open access transmission mandated by Order 888. FERC's decision that state regulatory commissions should address retail stranded costs rested on its conclusion that state-ordered wheeling, not FERC-mandated open access transmission, causes those costs to become stranded. See Order 888-A, ¶ 31,048 at 30,410. Recognizing a "limited" nexus between retail stranded costs and FERC-mandated open access stemming from FERC's jurisdiction over transmission rates and the resulting authority to award stranded costs, FERC nonetheless found no causal nexus between stranded costs and FERC-ordered transmission. Id. at 30,419. The lack of a direct causal nexus differentiates retail stranded costs from retail turned-wholesale stranded costs (see infra Section V.B.2).

Taking issue with this reasoning, the IOUs contend that FERC ignored "the central role played by the federal government" in shaping the electric energy industry. Because retail wheeling, according to the IOUs, is "a direct result of a federally created system of increased competition," FERC must take responsibility for all retail stranded costs.

Nowhere does FERC contest the nexus between state ordered wheeling and order 888's open access requirement. But the existence of a nexus does not require FERC to address stranded costs in light of the fact that in most instances state regulatory commissions will have authority to do so. Indeed because the costs were originally included in

retail rate bases, state agencies are better positioned to consider them. Given that it is state-ordered wheeling that most directly causes retail costs to become stranded, we find no reason to disturb FERC's judgment.

2. Stranded Costs Relating to Retail-Turned-Wholesale Customers

FERC concluded that open access transmission may, encourage what is known as "municipalization," where a town [Page 81] condemns a utility's distribution plant, becomes a wholesale customer of the utility, and utilizes open access transmission to purchase power on the competitive market. Concluding that costs incurred to serve former retail customers may become stranded due to the municipality's (the new wholesaler's) utilization of open access transmission, FERC decided to serve as the primary forum for resolution of stranded costs claims relating to new municipalizations. See Order 888-A, ¶ 31,048 at 30,402. FERC also decided to serve as the primary forum "in a discrete set of municipal annexation cases"—i.e., cases involving "existing municipal utilities that annex retail customer service territories and, through the availability of Commission-required transmission access, use the transmission system of the annexed customers' former supplier to access new suppliers to serve the annexed load." Order 888-B, ¶ 61,248 at 62,102. In such cases, FERC will determine on a case-by-case basis whether there exists the requisite nexus between municipal annexation and open access transmission. Recognizing that state regulatory authorities may be the first to address claims for stranded cost recovery in the retail-turned-wholesale scenario (FERC's label for new municipalizations and municipal annexations), FERC stated that it "will take into account state findings on cost determinations and will give great weight in [its] proceedings to a state's view of what might be recoverable." Id. at 62,105 (internal quotation marks omitted).

This issue provoked the only dissents to Order 888. Although neither dissenting commissioner disputed FERC's jurisdiction to allow recovery of these stranded costs, both faulted FERC for second-guessing state authorities regarding stranded costs. They thought that FERC should have acted as the forum for adjudicating these stranded cost issues only when state authorities failed to act altogether. See Order 888, ¶ 31,036 at 31,904-07 (Commissioner Hoecker concurring in part and dissenting in part); id. at 31,907 (Commissioner Massey dissenting in part).

Unlike the dissenters, both the States and POSCR challenge FERC's assertion of jurisdiction. According to the [Page 82]States, FERC usurped their role as protectors of retail customers by potentially undermining their rate treatment of retail costs, POSCR makes three arguments. Advancing claims similar to its arguments about stranded costs resulting from state-ordered retail wheeling (see Section V.B.1.a. supra), POSCR first contends, relying again on section 201(b), that FERC lacks jurisdiction to award retail stranded costs in the retail-turned-wholesale scenario. Second, it claims, FERC failed to weigh properly the adverse effects of Order 888 on franchise competition between utilities and municipalities. Finally, relying on the Hoecker and Massey dissents, POSCR argues that FERC acted arbitrarily and capriciously by declaring itself to be the primary forum for retail-turned-wholesale stranded cost claims. For their part, the IOUs fault FERC's failure to consider claims for recovery in the so-called "bypass" scenario. We address th se arguments in turn.

The States begin their argument by asserting that "[w]hen retail utility customers leave the utility's system because of municipalization the costs stranded by the customers' migration normally are not allocable ... to whatever wholesale utility service might be sold to the city for resale." While this may have been true in the past, the States' argument ignores FERC's conclusion that it is open

access transmission that makes municipalization feasible. Because FERC has determined that it will consider proposals for stranded cost recovery only when there is a direct nexus between municipalization and open access transmission, we see no basis for the States claim that FERC will "override Congress's instruction that the states be permitted to protect retail customers."

The answer to POSCR's first argument—that section 201(b) precludes FERC from awarding stranded costs in the retail turned-wholesale context—appears in our discussion of FERC's jurisdiction to address retail stranded costs resulting from state ordered retail wheeling. See Section V.B.1.a. supra. Because a town becomes a wholesale customer of the historic supplying utility when it municipalizes, FERC's exclusive jurisdiction over all aspects of wholesale sales gives [Page 83]FERC the authority it needs to include generation-related costs in rates, including even costs originally incurred to provide retail service. We find no reason to question FERC's decision to allocate stranded costs caused by retail-turned-wholesale customers to the cost of providing wholesale service subject to its jurisdiction. As in the retail wheeling context, these stranded costs are properly viewed as "costs" of the former supplying utility's, provision of open access transmission service. With respect to new municipalizations, the retail-turned-wholesale customer is able to reach a new generation supplier only because of open access transmission. And with respect to municipal annexations, FERC will require utilities to demonstrate a nexus between the annexation and open access transmission.

POSCR's second argument relates to what is known as "franchise competition." According to POSCR, franchise competition occurs "when a privately-owned utility is threatened by the prospect that a municipality may exercise powers of eminent domain to take over the utility's operations." POSCR argues that stranded cost recovery could impede franchise competition, which it says FERC has

always encouraged. Although this might well be true, the possibility that potential stranded cost liability could deter municipalities from taking advantage of open access does not undermine Order 888. As Order 888-A explains, "the purpose of the stranded cost policy is neither to encourage nor to discourage municipalization, but rather to facilitate a fair transition to competition and to ensure stability in the industry during that transition." Order 888-A, ¶ 31,048 at 30,405.

We turn finally to POSCR's claim that FERC acted arbitrarily and capriciously by declaring itself the primary forum for recovery of retail-turned-wholesale stranded costs. Asserting that FERC's action implicitly undermines state decisionmaking and encourages forum shopping, POSCR claims that Order 888's treatment of the retail-turned-wholesale scenario contravenes agency precedent and conflicts with the agency's decision to leave to the states the consideration of those stranded costs resulting from state-ordered wheeling.

[Page 84]While FERC did leave resolution of claims for wholesale-turned-retail stranded costs to the states in United Illuminating Co., 63 FERC ¶ 61,212 (1993), a pre-Order 888 case addressing a particular utility's application for stranded cost recovery, Order 888-A explains that, after reanalyzing the stranded cost problem, FERC concluded that "where such costs are stranded as a direct result of Commission-mandated wholesale transmission access, these costs should be viewed as costs of the transition to competitive wholesale bulk power markets and this Commission should be the primary forum for addressing their recovery." Order 888-A, ¶ 31,048 at 30,407. In our view, this explanation adequately distinguishes between recovery of stranded costs from retail customers and recovery from retail-turned-wholesale customers. In the former situation customers remain retail customers subject to state jurisdiction; in the latter situation, customers become wholesale customers subject to FERC's

exclusive jurisdiction. This very different result justifies FERC'S different treatment of the two situations.

The IOUs argue that FERC should have provided for stranded cost recovery from a retail-turned-wholesale customer who ceases to purchase power from a utility but does not use that utility's transmission service to reach another power supplier—the so-called "bypass" scenario. This argument requires little discussion. In declining to provide a mechanism for the recovery of bypass stranded costs, FERC explained that "Order No. 888 does not by its terms bar the recovery of costs that do not result from the use of Commission-required transmission access. Utilities may, as before, seek recovery of such non-open-access-related costs on a case-by-case basis in individual rate proceedings. The Commission will not prejudge those issues here." Id. at 30,409. Given FERC's discretion to proceed through adjudication rather than by generic rule, see SEC v. Chenery Corp., 332 U.S. 194, 201-03 (1947), the IOUs challenge is without merit.

* * *

As evidenced by the numerous petitions for review, FERC faced an enormously difficult task in fashioning a stranded [Page 85]cost recovery mechanism that fairly compensates utilities for past investments while transitioning the electricity industry to competition. FERC has done an admirable job. Producing a comprehensive, evenhanded record and carefully considering all commenters' claims, it adopted a stranded cost recovery policy that accomplishes its stated objectives, complies with the FPA, conforms to our case law, and reasonably accommodates all competing interests. No doubt, there were alternative approaches to stranded cost recovery—petitioners have pointed to several. No doubt some aspects of Order 888 could have been better supported. But given the extremely technical nature of these issues, as well as our highly deferential standard of review, we find no basis for questioning FERC's approach.

Although Order 888 may be characterized in many ways, it can hardly be said to be either arbitrary or capricious.

VI. CREDITS FOR CUSTOMER-OWNED FACILITIES AND BEHIND-THE-METER GENERATION

The Commission's Open Access Tariff requires that public utilities—or "transmission providers"—offer "network integration transmission service." This requirement is one of the key elements in the Commission's attempt to "remove impediments to competition in the wholesale bulk power marketplace," Order 888, ¶ 31,036 at 31,634. Network service allows a customer for instance, a municipal utility to use a transmission system in a manner comparable to the way the transmission provider utilizes its system to move power from its generators to its native load customers.[11] See Order 888, [Page 86] ¶ 31,036 at 31,736; id. at 31,751; Order 888-A, ¶ 31,048 at 30,260 n.247; id. at 30,325.[12] With network service, resources located throughout the system serve loads dispersed throughout the system. For this, the transmission provider incorporates the network customer's resources and loads (projected over a minimum ten-year period) into its own long term planning. Because network service ultimately provides the customer with the same full system ability for transmitting power as the transmission owner, the

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11 "Load" may be defined as "[t]he total demand for service on a utility system at any given time." Public Utilities Reports Glossary For Utility Management 84 (1992); See Also Carl Pechman, Regulating Power: The Economics of Electricity In The Information Age 11 (1993). The Tariff defines "native load customers" as the "wholesale and retail power customers of the Transmission Provider on whose behalf the Transmission Provider, by statute, franchise, regulatory requirement or contract, has undertaken an obligation to construct and operate the Transmission Provider's system to meet the reliable electric needs of such customers." Order 888-A, ¶ 31,048 at 30,508.

12 Public utilities must also offer point-to-point service, that is, transmis-sion service-reserved and/or scheduled between specified points of receipt and delivery. Order 888-A, ¶ 31,048 at 30,508.

Commission required that costs be allocated on the basis of a ratio of the network customers load to the transmission provider's entire load on its transmission system. A group of petitioners, led by Florida Municipal Power Agency (FMPA), challenge the Commission's use of this "load-ratio pricing."

The FMPA petitioners do not object to load-ratio pricing as such. In fact they think it "is a good method to allocate the costs of a transmission network among network owners or users," Brief of Credits for Customer-Owned Facilities, etc., at 3-4 ("Credits Brief"). Their principal complaint, repeated many times and in many ways throughout their briefs, stems from their view that as a practical matter the commission required that the network customer's total load be used in calculating the ratio,[13] even though some customers it sells power from local, 'behind the meter generation and transmission, or obtain power from more than one transmission system...." Id. at 8.[14] The FMPA petitioners say this [Page 87]allows "transmission providers to charge wholesale customers for network transmission that they do not want, need or use to provide electric power service to their customers." Id. at 18.

The Commission provided some relief in response to these complaints, but not enough to satisfy the FMPA petitioners. "Because of the diverse concerns raised by the commenters," the Commission wrote in the preamble to Order No. 888, "we are unable to resolve on the basis of this record the extent to which, or under what circumstances, cost

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13 The Commission did not actually require a customer to designate its total load to obtain network service: a customer may exclude all—not merely part—of its load at a discrete delivery point. See Order 888-A, ¶ 31,048 at 30,256-62.

14 Behind the meter generation [and transmission] means generation for transmission] located on the customer's side of the point of delivery." Order 888-A, ¶ 31,048 at 30,254 n.230.

credits related to customer-owned facilities would be appropriate under an open-access transmission tariff," Order 888, ¶ 31,036 at 31,742. Rather, this will be done on a case-by-case basis. The Commission warned, however, that mere interconnection between a customer's facilities and the transmission provider's facilities will not be sufficient to warrant a cost credit. Relying on Florida Municipal Power Agency v. Florida Power & Light Co., 67 F.E.R.C ¶ 61,167 (1994) (FMPA I), modified, 74 F.E.R.C. ¶ 61,006 (1996) (FMPA II), the Commission required the customer to demonstrate that its "transmission facilities are integrated with the transmission system of the transmission provider" and provide additional benefits to the transmission grid in terms of capability and reliability, and [are] relied upon for the coordinated operation of the grid." Order 888, ¶ 31,036 at 31,742; Order 888-A, ¶ 31,048 at 30,271. The Commission did, however, guarantee credits for new, integrated transmission facilities built by a customer if jointly planned with the transmission provider.

We detect nothing in the arguments of the FMPA petitioners to warrant setting aside this aspect of the Commission's rule. It is true that as the owners of generation and transmission facilities, any one of these petitioners can satisfy some of its needs. But network service, as the Commission defined it, means that network customers can call upon the transmission provider to supply not just some, but all of their load at any given moment, when for instance they experience blackouts or brownouts. The Commission decided that if a customer does not desire such full network service for its entire load, it may exclude loads at discrete delivery points [Page 88]and purchase point-to-point service instead. What it cannot do is split loads at delivery points. The FMPA petitioners object to the Commission's refusal to allow a split system, but their objection is not well-taken. They ignore the technical problems with a split system, stemming partly from the manner in which electrons flow and the impossibility of isolating loads from the transmission

providers system. See FPC v. Florida Power & Light, 404 U.S. 453 (1972). Furthermore, "such a split system creates the potential for a customer to 'game the system' thereby evading some or all of its load-ratio cost responsibility for network services." Order 888-A, ¶ 31,048 at 30,259.[15] The FMPA petitioners label this prospect a "fiction," but offer neither evidence nor reasoning to counter the Commissions expert judgment.[16]

As to credits, these petitioners maintain that if the Commission is going to use total "load-ratio pricing with Network Load defined as total customer load, simultaneous credits are required." Credits Brief at 41. What they mean by credits is reduced prices for any and all behind-the-meter facilities they own. The Commission's rejection of this blanket approach is well-supported. Credit may be given, but not automatically. The question can only be determined on a case-by-case basis because it depends on whether the customers facilities are truly integrated with the transmission system, rather than merely interconnected. Only if they are [Page 89]integrated will the transmission system benefit and only then, the Commission decided, should credits—which shift the costs of the customers facilities to the transmission provider's customers—be allowed. Order 888-A, ¶ 31,048 at

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15 Load-ratio cost responsibility is based on the customer's contribution to the transmission system peak each month. With a split system a customer could, at the time of the monthly system peak, increase its behind-the-meter generation in order to decrease its load-ratio cost responsibility, while making significant use of the transmission system throughout the rest of the month. See Order 888-A, ¶ 31,048 at 30,259 nn.244 & 245.

16 Petitioners claim that Florida Power Co., 81 F.E.R.C. ¶ 61,247 (1997), decided after Order No. 888, shows that it is not "necessary for customers to purchase amounts of network transmission equal to their entire load behind a delivery point." Credits Brief at 30. It shows no such thing. The case involved not network integration transmission service, but a sort of hybrid service called "network contract demand transmission service."

30,271. Petitioners call the Commission's rule in this regard "an unexplained and inexplicable retreat from FMPA v. FPL." Credits Brief at 42. It is nothing of the sort. The Commission made this abundantly clear. In FMPA I the Commission said that "if [a customer] has transmission facilities that will operate as part of the integrated transmission system, a credit would be reasonable." 67 F.E.R.C. at 61,482 n.76. And in FMPA II the Commission said that mere interconnection does not equal integration and that integration must be determined case by case. 74 F.E.R.C. at 61,010. This is completely consistent with the Commission's resolution of the credits issue in the proceedings before us.

The FMPA Petitioners' next objection deals with new customer facilities—that is, those built after network service begins under the Tariff. The Commission determined that "the Network customer shall receive a credit where such facilities are jointly planned and installed in coordination with the Transmission Provider." Order 888-A, ¶ 31,048 at 30,534. Petitioners begin by reading this as some sort of "limitation," they expand it into a "condition precedent for customers to receive credit for new facilities," and they end by treating it as a bar to "credits for new customer-facilities unless they are jointly planned," Credits Brief at 43, 44, 45. Commission counsel rightly points out that petitioners have completely misread the rule: "simply put, the Rule does not speak to the situation of new facilities built outside a joint planning effort." Commission Brief at 104. The Commission did determine that a joint planning mandate was "beyond the scope of this proceeding," Order 888-A, ¶ 31,048 at 30,311. Using their mistaken premise, petitioners insist that the Commission acted arbitrarily in this regard, giving transmission providers the power to block all customer credits for new facilities. See Credits Brief at 45. Since their presence is mistaken, their conclusion must be rejected. The balance of [Page 90]the FMPA petitioners' arguments have been considered and rejected.

VII. LIABILITY, INTERFACE ALLOCATION, AND DISCOUNTING

As part of Order 888, FERC adopted a pro forma Open Access Transmission Tariff (OATT), containing minimum terms and conditions for non-discriminatory service, which every transmission-owning public utility must file with the Commission and by which it must abide in providing transmission services to itself and others. Various petitioners have challenged isolated provisions of the OATT—specifically the provisions governing liability and indemnification, interface allocation, and delivery point specific discounting. We reject each of these challenges.

A. Liability and Indemnification

Prior to unbundling, retail tariffs were primarily a matter for state regulation, and most states had approved tariff provisions permitting utilities to limit their liability for service interruptions to instances of gross negligence or willful misconduct. Courts upheld these limitations on the public policy grounds that they balanced lower rates for all customers against, the burden of limited recovery for some, and that the technological complicity of modern utility systems and resulting potential for service failures unrelated to human error justified liability limitations. In the past, FERC also has allowed electric utility tariffs to explicitly limit a utility's liability for service interruptions to instances of gross negligence or willful misconduct.

One of the pro forma tariffs included in the Notice of Proposed Rulemaking contained a provision explicitly limiting the liability of transmission providers to circumstances of gross negligence or intentional wrongdoing. See Open Access NOPR, ¶ 32,514 at App. C § 15.0. Section 10.2 of the OATT requires the transmission customer to "at all times indemnify, defend, and save the Transmission Provider harmless from any and all damages ... except in cases of negligence or intentional wrongdoing by the

Transmission Provider." Order 888, ¶ 31,036 at 31,936-37 (emphasis added). In Order [Page 91]888, FERC justified the change with a single statement: "We find that this new indemnification provision would be too strict if it required customers to indemnify transmission providers even in cases, where the transmission provider is negligent." Order 888, ¶ 31,036 at 31,765.

The investor owned utility petitioners (IOUs) challenge the OATT's indemnification provision on the ground that FERC adopted the lesser ordinary negligence standard in Order 888 without first notifying interested parties that it was contemplating such a major policy change. The IOUs claim that the change in the provision's language represents a significant shift in indemnification policy, in that it leaves transmission providers open to claims of ordinary negligence for the first time. The courts consistently have relied upon explicit tariff provisions to enforce the gross negligence standard for liability, see, e.g., Southwestern Bell Tel. Co. v. Rucker, 537 S.W.2d 326, 330-32, 334 (Tex. App. 1976); and if the tariffs do not explicitly limit liability for ordinary negligence, the IOUs claim, the courts will assess such matters differently. Because FERC's notice was not clear that the liability standard was a subject or issue of the rulemaking, the IOUs claim that FERC denied their right to comment on the change. See, e.g., AFL-CIO v. Donovan, 757 F.2d 330 (D.C. Cir. 1985); McLouth Steel Prods. Corp. v. Thomas, 838 F.2d 1317 (D.C. Cir. 1988). Citing principally our opinion in Air Transport Association of America v. DOT, 900 F.2d 369, 379 (D.C. Cir. 1990), the IOUs contend that the fact that they were able to raise their concerns in their petition for rehearing is not a substitute for pre-issuance notice and comment.[17]

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[17] We recognize that Air Transport has been vacated. See Air Transport Association of America v. DOT, 933 F.2d 1043 (1991) (per curiam).

FERC responds by denying that the indemnification provision adopts a particular liability standard at all. FERC claims that it has merely distinguished liability from indemnification, and that the change to the pro forma tariff does not establish a new, simple negligence standard of liability for transmission providers. Citing its own statements in Order [Page 92]888-A, FERC asserts that the tariffs indemnification provision should not be construed as preempting state liability standards. See Order 888-B, ¶ 61,248 at 62,080-81. FERC maintains that, since the change to the indemnification provision does not represent a substantive alteration in policy or the standards governing legal liability, the Commission was not obligated to notify interested parties and seek comment. FERC accuses the petitioners of wanting FERC to impose a federal gross negligence liability standard, which FERC contends that it properly declined to do pursuant to United Gas Pipe Line Co. v. FERC, 824 F.2d 417 (5th Cir. 1987) (rejecting the need for a federal liability standard for pipelines).

The IOUs charged that FERC has deleted a limitation of liability to gross negligence from the existing background of utilities liability law and has done so without substantial evidence and without exercising reasoned decision making. See Mid-Tex Elec. Coop., Inc. v. FERC, 773 F. 2d 327, 338 (D.C. Cir. 1985) (the Commission's decision must be supported by substantial evidence and be the result of reasoned decision making). The Commission denies that it has established a standard of liability nearly so sweeping as the IOUs fear. We agree with FERC's reading of the rule. While the petitioners argue that the rule works a "dramatic change" regarding the liability of electric utilities by imposing an ordinary negligence rather than a gross negligence standard that previously prevailed, in fact, the rule does not establish a new simple negligence standard of liability for transmission providers. While we read FERC's interpretation of its own rule deferentially see—Jersey Shore Broad. Corp. v. FERC, 37 F.3d 1531, 1536 (D.C. Cir. 1994),

by any standard, its construction is correct in the present controversy and the preamble to the regulations before us, FERC plainly describes the disputed provision as an "indemnification" provision, and recites reasoning supporting the particular indemnification provision it adopted. "[T]his new indemnification provision would be too strict if it required customers to indemnify transmission providers even in cases where the transmission provider is negligent." Order 888, ¶ 31,036 at 31,765. [Page 93]In the preamble to Order 888-A, in a section concededly headed "*Liability* and Indemnification" (emphasis added), FERC explains the later version of the relevant provisions in terms consistent with the Order 888 preamble. See generally Order 888-A, ¶ 31,048 at 30,299-302. Finally, in Order 888-B, FERC summarizes its reasoning for its indemnification and liability decisions, again both adequately and in ways not amounting to the adoption of the universal standard as asserted by the IOUs. See generally Order 888-B, ¶ 61,248 at 62,079-81. In short, FERC's rule does not work so sweeping a change in the legal landscape as the IOUs assert, and FERC has exercised reasoned decisionmaking in support of such pronouncements as it has made.

Insofar as the IOUs challenge the adequacy of FERC's notice in the NOPR that it was contemplating a change in the indemnification and liability provisions of pro forma tariffs, that challenge also fails. It is well established that a final rule need not be identical to the original proposed rule. See, e.g., AFL-CIO v. Donovan, 757 F.2d at 338; Trans-Pacific Freight Conference v. Federal Maritime Comm'n, 650 F.2d 1235, 1249 (D.C. Cir. 1980). Were the change between the proposed and final rule an important one, we would have to ask whether the final rule is a logical outgrowth of the proposed one. See, e.g., National Mining Ass'n v. Mine Safety & Health Admin., 116 F.3d 520, 531 (D.C. Cir. 1997). Not all changes are sufficiently important to warrant such scrutiny and concern, however. "An agency, after all, must be free to adopt a final rule not described exactly in the

[notice of proposed rulemaking] where the difference is sufficiently minor, or agencies could not change a rule in response to valid comments without beginning the rulemaking anew." National Cable Television Ass'n v. FCC, 747 F.2d 1503, 1507 (D.C. Cir. 1984).

We agree with FERC that its indemnification provision does not preclude the states from shielding utilities from liability for ordinary negligence. States did so before, through both their regulatory commissions and their courts; and they remain free to do so under Order 888. The deletion of the gross negligence language from the pro forma tariffs indemnification provision does not significantly change the [Page 94]petitioners' legal position. Therefore, contrary to the IOUs challenge, the deviation of the final rule from the proposed one is not a major one; and FERC's failure to notify interested parties that it was, considering the change does not render the provision arbitrary or capricious under the APA. Accordingly, we affirm this portion of the pro forma tariff.

B. Interface Allocation

The IOUs also challenge FERC's treatment of interface allocation as unsupported by the record and contrary to reasoned decision making. Section 30.8 of the pro forma tariff addresses how much of a transmission provider's interface capacity a network customer can use. See Order 888, ¶ 31,036 at 31,954-55. Interface capacity represents the capability of a transmission facility to transfer power between two utilities. Section 30.8 permits a network customer to use a transmission provides capacity to the extent of the network customer's total load without limitation.

In the rulemaking process, several parties argued that a fair method of interface allocation would be the use of a load ratio, under which the transmission provider and each network customer would be allocated a share of each specific

interface based upon their respective loads. Nevertheless, in Order 888, FERC ruled that network customers could use any of the transmission providers' interfaces to import up to their full load on a first-come, first-served basis. The IOUs maintain that this ruling does not promote an equitable allocation of a transmission provider's interfaces.

The IOUs also note that, responding to the IOUs petition for rehearing on this issue in Order 888-A, FERC merely referenced Florida Municipal Power Agency v. Florida Power & Light Co., 74 F.E.R.C. ¶ 61,006 (1996) (hereinafter FMPA II), to support its conclusion, without addressing either the comments or the rehearing petitions. FERC meanwhile maintains it found the load ratio share method advocated by some transmission owners to be unreasonable for the same reasons discussed at length in FMPA II Intervenors add that the IOUs' challenge of the aggregate, [Page 95]first-come, first-served approach adopted by FERC as inequitable merely reflects a disagreement with FERC's policy choice.

Whether to adopt a load ratio share approach. or an aggregate, first-come, first-served approach to capacity allocation is a matter of policy. Again, the IOUs have not challenged FERC's legal authority to select a particular interface allocation method, but rather whether FERCs choice was based upon reasoned decision making. Accordingly, we evaluate FERC's treatment of interface capacity allocation under the APA's arbitrary and capricious standard. See 5 U.S.C. § 706(2)(A) (1994).

FERC's analysis of the issue in the present rulemaking consists solely of a reference to and quotation from its earlier in FMPA II. See Order 888-A, ¶ 31,048 at 30,304-05. That proceeding involved an application by Florida Municipal Power Agency for open access to Florida Power & Light Company's transmission facilities pursuant to FPA §§ 211 and 212. See FMPA II, 74 F.E.R.C. ¶ 61,006 at 61,004; see also Florida Mun. Power Agency v. Florida Power & Light

Co., 67 F.E.R.C. ¶ 61,167 (1994) (hereinafter FMPA I). In FMPA I and FMPA II, FERC justified its choice of policies as follows:

> [T]here are no restrictions on the use of other parts of the transmission system. If the interfaces are constrained, Florida Power and FMPA should simply redispatch and share the redispatch costs and, ultimately, Florida Power will build new facilities when needed. The interfaces, are just another part of the transmission grid, and Florida Power must plan and operate the grid, including, the interfaces, to meet the combined needs of Florida Power and FMPA on an equal basis. When there are conflicting needs to use the same interface capacity, the parties have already agreed that the combined Florida Power and FMPA systems will be redispatched and the costs shared. When the grid, including interfaces, needs to be expanded, Florida Power will undertake the expansion on behalf of the combined system.

[Page 96] FMPA II 74 F.E.R.C. ¶ 61,006 at 61,018 (quoting FMPA I, 67 F.E.RC. ¶ 61,167 and 61,484. While FERC's recognition of the petitioner's concerns was certainly cursory, and its language in FMPA II is slightly oblique, FERC has adequately demonstrated that it gave full consideration before rejecting load ratio share in favor of aggregate, first-come, first-served capacity allocation. Accordingly, we uphold FERCs ruling on the interface capacity allocation issue.

C. Different Point-Specific Discounting

Two groups of transmission dependent utilities, TAPS and TDU Systems, and the nation's largest power wholesaler, Enron Power Marketing (collectively the U&D petitioners), challenge FERC's decision to permit delivery-point-specific discounting. Electric utilities often offer both firm and non-

firm service. Firm service permits customers to demand transmission at any time, while non-firm service permits the utility to cut service when there is not enough excess capacity.

In Order 888, FERC allowed transmission providers to offer discounted rates for non-firm service only if they gave the same discounted rate to all customers for the same transmission path and on all other unconstrained transmission paths. See Order 888, ¶ 31,036 at 31,743-44. FERC also required that the discounts be posted in advance so that all customers could have equal opportunity to take advantage of the discounted rate. See id. at 31,744. In Order 888-A, FERC narrowed the requirement, so that a transmission provider offering a discount on a particular path need only provide the same discount to all other unconstrained paths that go to the same delivery point in the provider's system. See Order 888-A, ¶ 31,048 at 30,275-76. FERC also said that a transmission provider should discount only if necessary to increase throughput on its system. See id. at 30,274.

The U&D petitioners contend that delivery-point-specific discounting results in higher transmission rates for transmission dependent utilities (TDUs), who rely on point-to-point service rather than network service for their transmis-[Page 97]sions. Delivery point-specific discounting permits transmission facility owners to select the delivery points for which they will discount firm and non-firm service. The U&D petitioners argue that this discounting method allows transmission facility owners to discriminate by denying discounts to the delivery points used by the TDUs, thereby raising the transmission costs of these competitors, and in turn decreasing competition at both retail and wholesale.

Additionally, because of the subordination and interruptibility of non-firm service, the U&D petitioners claim that FERC's longstanding pricing policies utilized

discounting as the mechanism for ensuring that non-firm service was priced below firm service. The notice of proposed rulemaking emphasized FERC's reliance on non-discriminatory discounting to achieve higher firm service rates than non-firm rates, so that non-firm rates would reflect the interruptibility of transmission services and be economically efficient. The petitioners argue that FERC's decision in Order 888 to deny discounting of non-firm rates unless firm rates are also discounted an unexplained reversal of that longstanding pricing policy. By adopting a deliver-point-specific discounting rule, the petitioners claim that FERC subjects TDUs to firm rates for all non-firm service. As a result, the petitioners contend, the price that TDUs have to pay for non firm service does not reflect the interruptibility of that service. The petitioners maintain that this aspect of FERC's order itself represents undue discrimination, and that FERC failed to explain why it rejected a compromise position which would restrict opportunities for discrimination and address concerns that the new rules discourage discounting.

FERC notes that it discussed the discounting issue in Orders No. 888, 888-A, and 888-B. See Order 888, ¶ 31,036 at 31,743-44; Order 888-A, ¶ 31,048 at 30,272-76; Order 888-B, ¶ 61,248 at 62,072-75. FERC accuses the petitioners of wanting the Commission to require transmission providers to discount all non-firm services below firm rates regardless of the facts of the particular case. FERC asserts that it did not seek to discourage discounting, but was concerned that if it required discounting on all unconstrained paths as a condition [Page 98]for offering discounts, transmission providers would be discouraged from offering any discounts at all. Fewer discounts could lead to decreased use of transmission services, and therefore a decline in overall transmission revenues, and a corresponding increase in transmission rates to enable transmission providers to recover their costs. FERC maintains that the petitioners, like everyone else, retain the opportunity to compete with the

transmission provider for power sales to the same delivery point at the same discounted rate. FERC argues that its orders are consistent with its established pricing policy of permitting flexibility to reflect interruptibility and efficient use of the transmission system, subject to the firm price cap. In most case, FERC expects that non-firm transmission rates will be priced below the firm rate.

Although the petitioners hint at a statutory claim by alleging that FERC's orders result in undue discrimination and higher rates in violation of the FPA's statutory mandate, the petitioners generally confine themselves to arguing that FERC's decisions to permit delivery-point-specific discounting and non-firm rates equal to firm rates represent unexplained departures from established policy. We therefore analyze this issue under the arbitrary and capricious standard of the APA. See 5 U.S.C. § 706(2)(A).

With respect to non-firm versus firm rates, the cases cited by the petitioners as demonstrating a previously established discounting policy actually establish that FERC addresses this issue on a case-by-case basis. For example, in Kentucky Utilities Co., 15 F.E.R.C. ¶ 61,002 (1981), FERC said that the utility could not allocate capacity costs to non-firm transmission service since such service did not factor into the utility's capacity decisions. In contrast, in Central Maine Power Co., 60 F.E.R.C. ¶ 61,285 (1992), while FERC noted that non-firm service generally warrants a rate lower than firm service, FERC also upheld the utility's decision not to offer non-firm rate discounts on several contracts. Indeed, the petitioners acknowledge that FERC's pre-Order 888 Transmission Pricing Policy Statement, 59 Fed. Reg. 55,031 (1994), does not [Page 99]expressly require non firm rates to be priced below firm rates in all cases. See Br. of U&D Petitioners at 2400.

The petitioners cite American Electric Power Service Corp., 82 F.E.R.C. ¶ 61,090 (1998), for the proposition that, after adopting delivery-point-specific discounting, FERC has

refused to consider whether non-firm rates should be lower than firm rates; but in that case, FERC did consider that issue found the rates in question to be nondiscriminatory, and refused only to consider the petitioners generic challenges to its broader policy of flexibility. Additionally, the petitioners charge that FERC's acceptance of firm rates for non-firm service conflicts with this court's decision in Fort Pierce Utilities Authority v. FERC, 730 F.2d 778, 788-89 (D.C. Cir. 1984); but in that case, this court merely noted that FERC had failed to reconcile its decision to allocate capacity costs to non-firm transmission service with its previous refusal to do so in Kentucky Utilities, and remanded for further consideration. In short, FERC does not appear to have changed its overall pricing policy at all, except to fine tune its guidance as to when discounting might be considered discriminatory.

Which brings us to whether delivery-point-specific, discounting in fact discriminates against the TDUs. Essentially, FERC and the petitioners offer conflicting discounting theories, both of which seem plausible. In its request for rehearing, TAPS observed that, by allowing transmission providers to select which delivery points merit discounts, FERC permits the providers to select for discounting those delivery points which serve their affiliates, and not to select the similarly situated delivery points which serve the TDUs. On rehearing, FERC quite logically maintained that requiring transmission providers to apply discounts to all unconstrained transmission paths could discourage discounting generally, resulting in higher rates for all. See Order 888-A, ¶ 31,048 at 30,275. FERC subsequently asserted that requiring transmission providers to offer the same discount for the same time period on all unconstrained paths that go, to the same [Page 100]delivery point will achieve sufficient comparability. See Order 888-B, ¶ 61,248 at 62,075. FERC noted that it will be able to monitor the discounting behavior of transmission providers for discrimination through the data posted on OASIS. See id.

The record reflects that FERC considered fully all of the arguments, and concluded that delivery-point-specific discounting best accomplished comparability while encouraging discounting. Thus, the discounting policies outlined in Orders 888, 888-A, and 888-B are not arbitrary or capricious. We therefore affirm FERC's resolution of this issue.

VIII. TARIFF TERMS AND CONDITIONS

A. Headroom Allocation

Firm point-to-point service, as distinguished from network service, is transmission service reserved and/or scheduled between specified points of receipt and delivery. See Order 888-A, ¶ 31,048 at 30,508. Point-to-point customers may not need all the service for which they contracted. The Commission decided that they may, without extra charge, use their excess capacity to make firm sales between the receipt and delivery points specified in their agreement. Section 22.1 of the Tariff gives them another option for dealing with this "headroom. "The point-to-point customer may, without charge, have the public utility provide transmission on a non-firm basis over receipt and delivery points other than those "specified in the service agreement (so-called "secondary" points).

Network customers describing themselves as Transmission Dependent Utilities (TDUs) contend that the flexibility given to point-to-point customers to sell their unused capacity should also be given to them. Three transmission providers[18]—the CPL petitioners-want restrictions placed on point-to-[Page 101]point customers in order to avoid Putting the customers at a competitive advantage. The Commission refused to adopt there proposals for reasons we believe are sound.

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[18] Carolina Power & Light Company (CPL), Florida Power & Light Company and Niagara Mohawk Power Corporation.

As to transmission providers, the Commission noted that if they want to make off-system sales they too must take point-to-point service; in doing so they gain the same flexibility as regular point-to-point customers. See Order 888, ¶ 31,036 at 31,751. For network customers, the Commission stated that they "are not obligated to take network transmission service" and if they wait to take advantage of the as-available, non-firm service over secondary points of receipt and delivery through the point-to-point service, they may elect to take firm point-to-point transmission service in lieu of the network service." Order 888-A, ¶ 31,048 at 30,253. The Commission properly insisted on maintaining its basic distinctions between network service and point-to-point service. Unlike a point-to-point customer, a network customers rights are defined in terms of capacity needed and thus "vary as the customer's load varies," rendering them not sufficiently definite and defined to be "reassignable in the secondary market." Id. at 30,223. At least one of the TDUs agreed with the Commission "that, because there is no fixed capacity reservation for network customers, allowing them unrestricted use of capacity to make off-system sales without additional charge would give such customers a competitive advantage over [point-to-point] customers." Terms and Conditions Brief at 11.[19]

B. Headroom Prioritization

Some petitioners complain that secondary non-finn point-to-point customers should not have been placed in a status below non-firm point-to-point customers and that the

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19 These petitioners add that the Vermont Department of Public Service (VDPS) offered a solution to the problem but the Commission overlooked it. Terms and Conditions Brief at 12. This is not correct. The Commission did consider the Vermont proposal, finding it to be an "artifice derived from the load ratio share calculation," a "formula [that] does not result in a reassignable capacity right." Order 888-A, ¶ 31,048 at 30,223.

Com-[Page 102]mission offered no explanation for its doing so. See Terms and Conditions Brief at, 14-17. The Commission did explain itself. Firm point-to-point customers are permitted to designate secondary receipt and delivery points at no extra charge and therefore "are properly accorded a lower priority than stand alone, non-firm transmission." Order 888-A, ¶ 31,048 at 30,281. Furthermore, the Commission promised to reevaluate its approach in response to any "future transmission rate proposal that is based on the concept of tradable capacity rights," but it was moving cautiously because in the electric utility industry (unlike the natural gas industry) such "trading rights simply do not exist at this time." Id.

C. Duplicative Charges

The TDU petitioners argue that the new rules cause them to be double-charged in certain transactions. They first object to the Commission's decision that in power exchanges (flows in one direction for a time and then flows in the opposite direction) each party must reserve and pay for transmission along the same path. See Terms and Conditions Brief at 18. The Commission's response was that traditionally and "from the transmitting utility's planning and reservation perspective," the power exchange consists of two, one-way transmission services. Commission Brief at 115. Petitioners offer no legal basis for us to prefer their treatment to that of the agency and so we will not disturb the Commission's approach.

Petitioners' second objection is that the Tariff double counts network load served by two- separate energy suppliers because, "[i]f two separate suppliers purchase network service to supply a portion of the load for a particular customer, the entire load of the customer is included in calculating the reservation charges paid by both supplying network customers, unless each load portion is isolated electrically from the other." Terms and Conditions Brief at 21. We confess to some difficulty in comprehending

petitioners' complaint. It seems perfectly reasonable to answer, as the Commissions counsel does, that "there is no rational basis- for both the network transmission customer and its power marketer sup-[Page 103]plier to designate the same load under the Tariff." Commission Brief at 115. The power supplier itself may, the Commission pointed out purchase network service; we cannot see why both the power supplier and the power buyer would purchase such service when a purchase by either would suffice. Petitioners seem to concede that in some instances the double-counting problem could be avoided in this manner, yet they think that in some other, ill-defined circumstance it could not. This rulemaking set forth the standard tariff terms. If Petitioners, or any one of them, have some unique circumstances warranting an adjustment, there will be time enough for them to seek relief from the Commission.

D. Multiple Control Areas

Network customers may wish to serve loads in two or more control areas. Some commenters were concerned that such customers would have to pay a network transmission rate to two or more transmission providers based on the customers total load. See supra Section VI (credits for customers). The Commission had several responses. First, the risk could be avoided or alleviated by the customer's purchasing point-to-point service, or a combination of network and point-to-point service at discrete delivery points (thereby reducing its load ratio). Or the customer could purchase network service alone in each transmission provider's control area. See Order 888-B, ¶ 61,248 at 62,096 n.157. If the customer insists on foregoing the last option, it can hardly expect that the additional service it is demanding—the moving of power from one transmission provider's system to another system—should be free of charge. As the Commission put it:

> Because the additional transmission service to non-designated network load outside of the transmission

> provider's control area is a service for which the transmission provider must separately plan and operate its system beyond what is required to provide service to the customer's designated network load [within the control area], it is appropriate to have an additional charge associated with the additional [point-to-point] service.

[Page 104] Order 888-A, ¶ 31,048 at 30,255, quoted in Order 888-B, 81 F.E.R.C. ¶ 61,248 at 62,096. This is consistent with the handling of an analogous situation involving separate transmission systems in the past. See Fort Pierce Utils. Auth. v. FERC, 730 F.2d 778, 781-85 (D.C. Cir. 1984).[20]

E. Right-of-First-Refusal

In order to preserve the certainty and continuity of transmission service the Commission granted existing customers a right-of-first-refusal (ROFR) upon the expiration of contracts exceeding one year provided that the existing customer agreed to match the contract price and term of any party, competing for that service. See Order 888, ¶ 31,036 at 31,665. The Commission did not set an upper limit on the terms that a competing party could offer, but chose instead to allow the market to determine rates and terms. Petitioners argue that the Commission's failure to establish an upper limit should be set aside and remanded for further consideration. The Commission conceded error on this point at oral argument in light of United Gas Distribution Cos. v. FERC, 88 F.3d 1105, 1138-40 (D.C. Cir. 1996). We

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[20] Petitioners claim that the Commission failed to consider a particular proposal related to this subject. See Terms and Conditions Brief at 33. It is unnecessary to describe the- proposal. All that need be said is that the Commission rejected a nearly identical proposal and gave its reasons for doing so. See Order 888-B, ¶ 61,248 at 62,096.

therefore remand this matter to the Commission so that it may provide a reasonable cap on contract extensions.[21]

[Page 105]IX. NATIONAL ENVIRONMENTAL POLICY ACT AND REGULATORY FLEXIBILITY ACT COMPLIANCE

A. NEPA Compliance

One investor-owned utility, Public Service Electric & Gas Company ("PSE&G"), claims that FERC failed to comply with the National Environmental Policy Act ("NEPA"), 42 U.S.C. §§ 4321 et seq. It argues first that the base case FERC adopted to evaluate the effects of open, access transmission was unreasonable because it "defined away" the effects of open access. Second, it argues, FERC acted arbitrarily and capriciously by failing to undertake measures to mitigate the environmental impact of Order 888.

1. Adequacy of Base Case

NEPA requires federal agencies contemplating a major action "significantly affecting the quality of the human environment" to prepare a thorough analysis of the action's environmental impact. 42 U.S.C. § 4332(C). The statute requires that environmental impact studies include "a detailed statement [of] alternatives to the proposed action." Id. § 4332(C)(iii).

In its environmental impact study prepared in connection with Order 888, FERC identified as the base case alternative a scenario that "maintains] the status quo." FERC Final Environmental Impact Statement, Promoting Wholesale

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[21] The TDU ¡ etitioners stated in their reply brief that Commission counsel's explanation of § 13.2 of the Tariff, as amended in Order No. 888-A and as interpreted in Madison Gas & Electric Co., 82 F.E.R.C. ¶ 61,099 at 61,372 (1998), to, apply only to short term customers satisfies their objection. See Terms and Conditions Reply Brief at 25. The remaining arguments of these petitioners not discussed in this part or in part V have been considered and rejected.

Competition through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of stranded Costs by Public Utilities and Transmitting Utilities at 2-1 (Apr. 1996) ("FEIS") Under that scenario, FERC would continue on a case-by-case basis to (1) condition approval of mergers and applications for sales at market rates on the filing of open access tariffs and (2) approve open access wheeling orders under section 211 of the FPA. Id.

Several commenters (including EPA) argued that FERC should adopt as its base case an alternative that freezes the status quo, i.e., assumes that no further open access transmission of any kind occurs and that efficiency in the industry remains unchanged. See id. at 6-1. Characterizing this [Page 106] "frozen efficiency" case as unreasonable, FERC declined to adopt it as the base case. See id. at 6-9-6-14. It nevertheless conducted sensitivity analyses comparing emissions under the frozen efficiency case with those under its base case. This comparison revealed "modest" reductions in emissions under the frozen efficiency case in certain circumstances. Id. at 6-4. When market conditions favor coal versus natural gas, NO, emissions under the base case are higher than under the frozen efficiency case by two percent in 2000, three percent in 2005, and five percent in 2010. Id. at 6-15. But when market conditions favor gas, the base case produces more favorable environmental benefits for all three years. Id. at 6-17.

We evaluate agency compliance with NEPA under a rule of reason standard. "[A]s long as the agency's decision is 'fully informed' and well-considered it is entitled to judicial deference and a reviewing court should not substitute its own policy judgment." Natural Resources Defense Council, Inc. v. Hodel, 865 F.2d 288, 294 (D.C. Cir. 1988) (quoting North Slope Borough v. Andrus, 642 F.2d 589, 599 (D.C. Cir. 1980)).

PSE&G argues that FERC, in adopting its base case, "defined away" the impact of open access by comparing the

environmental effects that would result from immediate implementation through Order 888 to those that would result from gradual implementation. Calling FERC's evaluation of the frozen efficiency case "cursory," PSE&G contends that the proper no action base case is not to implement-open access at all.

Given the terms of NEPA and our highly deferential review, we think FERC's FEIS complied with the statute. For one thing, NEPA does not require that a certain alternative be adopted as the base case. Rather, NEPA requires that agencies include in their FEIS analysis of "alternatives to the proposed action." 42 U.S.C. § 4332(c)(iii). Thus there is no merit to the contention that NEPA requires FERC to adopt the frozen efficiency case as the base case. We agree with PSE&G that one of the alternatives NEPA requires FERC to consider is the alternative of no action. [Page 107]But based on our own examination of the FEIS, we think that FERC devoted sufficient attention to evaluating the frozen efficiency case (what PSE&G calls the action alternative) to satisfy NEPAs requirements. In conducting sensitivity analyses to its base case, FERC identified the changes in both NO and CO_2 emissions that the frozen efficiency case would produce. Given that FERC's comparison of the frozen efficiency case to its case yielded little difference, the agency had no reason to conduct further analysis. By rigorously examining the frozen efficiency case even though it believed the case to be unreasonable, FERC ensured that its decision was "fully informed" and "well-considered." Hodel, 865 F.2d at 294.

2. Failure to Adopt Mitigation Measures

PSE&G argues that FERC acted arbitrarily and capriciously by failing to adopt measures to mitigate the expected harmful effects of Order 888. Noting that an agency must environmental effect consider mitigation if the proposed action would result in adverse environmental impacts, FERC considered but ultimately rejected any

mitigation measures. See FEIS § 7. In reaching this conclusion, FERC relied on (1) the fact that any mitigation measures it might undertake are unwarranted in view of Order 888's small impact (especially given that its effects are as likely to be beneficial as harmful) and (2) its lack of expertise in atmospheric chemistry, together with the fact that any impact of open access would be "dwarfed by the far larger existing ozone and NO_x, emission issues" currently being dealt with by EPA under its Clear Air Act authority. FEJS at 7-47-7-48.

The heart of PSE&G's challenge is this: downwind utilities, which are subject to NO_x reduction requirements, will face increased compliance costs due to the purported increase in emission levels resulting from Order 888; by comparison, upwind utilities that generate the pollution but are not subject to NO_x reduction requirements will experience no increased costs. PSE&G insists that FERC remedy this "undue preference" for upwind utilities.

[Page 108]Given that FERC has identified only small increases 'in emissions resulting from open access transmission—indeed, under some circumstances, the Commission predicted small decreases—we think it was entirely reasonable for FERC to decline to adopt mitigation measures to address a problem that it believed might not even develop. Not relying solely on Order 888's relatively insignificant environmental impact, however, FERC comprehensively analyzed proposed mitigation measures, explaining why it declined to require any. In light of this thorough analysis, we think FERC's conclusion that No_x emission increases resulting from Order 888, if any, are best addressed by EPA and the states through a comprehensive emissions control program is hardly arbitrary or capricious. We therefore have no need to resolve the parties' debate about FERC's legal authority to order environmental mitigation.

PSE&G also argues that FERC employed unreasonable assumptions in the FEIS and ignored its own data showing adverse environmental impacts. In our view, these arguments amount to an effort by PSE&G to substitute its own analysis for FERC's. To prevail in this court, it must demonstrate that FERC's analysis is arbitrary and capricious, a showing it has fallen far short of making.

B. Regulatory Flexibility Act Compliance

The Regulatory Flexibility Act requires agencies to conduct a regulatory flexibility analysis for any final rule. The Act exempts agencies from this requirement if they certify that "the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities." 5 U.S.C. § 605(a)-(b). Invoking this exemption, FERC certified that both Order 888 (open access) and Order 889 (OASIS and standard of conduct rules) would have no such impact. Order 888, ¶ 31,036 at 31,896; Order 889, ¶ 31,035 at 31,628.

The TDU petitioners claim that FERC failed adequately to consider the impact of Orders 888 and 889 on nonjurisdictional entities that may have to provide open access transmission and file open access tariffs under the orders reciprocity provisions. In contrast to jurisdictional utilities, several non-[Page 109]jurisdictional utilities are classified as small entities. According to TDU petitioners, the orders impose a significant economic burden on them, requiring compliance activities as well as alterations to their operations.

Although the RFA's judicial review provision was amended in 1996, see Small Business Regulatory Enforcement Fairness Act, Pub. L. No. 104-12 1, tit. II 110 Stat. 857 (1996), the TDU petitioners and FERC agree that the pre-amendment version of the RFA applies in this case. Under that version, our review is quite narrow. Section 611 (b) provided that "[a]ny regulatory flexibility analysis ... and

the compliance or noncompliance of the agency with the provisions of this chapter shall not be subject to judicial review. When an action for judicial review of a rule is instituted, any regulatory flexibility analysis for such rule shall constitute part of the whole record of agency action in connection with the review." 5 U.S.C. § 611(b) (1994). We have interpreted this language to mean that "'a reviewing court should consider the regulatory flexibility analysis as part of its overall judgment whether a rule is reasonable and may, in an appropriate case, strike down a rule because of a defect in the flexibility analysis.' We emphasize[ ], however, that 'a major error in the regulatory flexibility analysis may be, but does not have to be, grounds for overturning a rule.'" Mid-Tex Elec. Co-op, Inc. v. FERC, 773 F.2d 327, 340-41 (D.C. Cir. 1985) (quoting Small Refiner Lead Phase-Down Task Force v. EPA, 705 F.2d 506, 537-39 (D.C. Cir. 1983)).

In this case, FERC explained that Orders 888 and 889, considered in their entirety, do not have a "significant" impact on a "substantial" number of small entities. According to FERC, the orders will affect nonjurisdictional utilities only in the limited situation where they take advantage of a jurisdictional utility's open access transmission tariff. Given our highly deferential standard of review, and given the fact that petitioners have offered nothing other than their own views to the contrary, we have no basis for questioning FERC's judgment.

[Page 110]FERC, moreover, was not insensitive to the potential impact of Order 888 on small nonjurisdictional entities. Order 888 contains a waiver provision allowing these entities to seek an exemption from compliance with the reciprocity conditions. See 18 C.F.R. § 35.28(e)(2) (allowing nonjurisdictional utilities to file a request for waiver "for good cause shown"). As of March 1997, FERC had granted waivers to thirty-six small entities. See Order 888-A, ¶ 31,049 at 30,578.

Most important in view of our standard of review, nothing in petitioners' arguments causes us to question the reasonableness of the reciprocity provisions themselves. See Mid-Tex, 773 F.2d at 340-41. We therefore affirm FERC's RFA certification.

CONCLUSION

In summary, we affirm Orders 888 and 889 in all respects except as specifically provided above.

APPENDIX C

Order of the United States Court of Appeals for the District of Columbia Circuit filed Aug. 22, 2000

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 97-1715 September Term, 1999

Transmission Access Policy Study Group,
Petitioner

v.

Federal Energy Regulatory Commission,
Respondent

Vermont Department of Public Service, et al.,
Intervenors

Consolidated with 98-1111, 98-1122, 98-1113, 98-1114, 98-1115, 98-1118, 98-1119, 98-1120, 98-1122, 98-1124, 98-1125, 98-1126, 98-1127, 98-1128, 98-1129, 98-1131, 98-1132, 98-1134, 98-1136, 98-1137, 98-1139, 98-1140, 98-1141, 98-1142, 98-1143, 98-1145, 98-1147, 98-1148, 98-1149, 98-1150, 98-1152, 98-1153, 98-1154, 98-1155, 98-1156, 98-1159, 98-1162, 98-1163, 98-1166, 98-1168, 98-1169, 98-1170, 98-1171, 98-1172, 98-1173, 98-1174, 98-1175, 98-1176, 98-1178, 98-1180

BEFORE: Edwards, Chief Judge; Silberman, Williams, Ginsburg, Sentelle, Henderson, Randolph, Rogers, Tatel and Garland, Circuit Judges

ORDER

Upon consideration of petitioners' petition for rehearing en banc, and the absence of a request by any member of the court for a vote, it is

ORDERED that the petition be denied.

Per Curiam

FOR THE COURT:
Mark J. Langer, Clerk
By: s/Robert A. Bonner
Robert A. Bonner
Deputy Clerk

Circuit Judges Silberman and Henderson did not participate in this matter.

Filed On: UNITED STATES COURT OF APPEALS
FOR DISTRICT OF COLUMBIA CIRCUIT

Filed: AUG 22 2000
Clerk

APPENDIX D

***Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities and Transmitting Utilities*, Order No. 888, [1991-96 Reg. Preambles] F.E.R.C. Stats. & Regs. ¶ 31,036 (1996) (pertinent portions)**

APPENDIX D

[31,632]

[¶31,036]

61 F.R. 21540 (May 10, 1996)

18 CFR Parts 35 and 385

[Docket Nos. RM95-8-000 and RM94-7-001; Order No. 888]

Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities

Issued April 24, 1996

AGENCY: Federal Energy Regulatory Commission, DOE.

ACTION: Final rule.

SUMMARY: The Federal Energy Regulatory Commission (Commission) is issuing a Final Rule requiring all public utilities that own, control or operate facilities used for transmitting electric energy in interstate commerce to have on file open access non-discriminatory transmission tariffs that contain minimum terms and conditions of non-discriminatory service. The Final Rule also permits public utilities and transmitting utilities to seek recovery of legitimate, prudent and verifiable stranded costs associated with providing open access and Federal Power Act section 211 transmission services. The Commission's goal is to remove impediments to competition in the wholesale bulk power marketplace and to bring

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more efficient, lower cost power to the Nation's electricity consumers.

EFFECTIVE DATE: This Final Rule will become effective on July 9, 1996.

FOR FURTHER INFORMATION CONTACT: David D. Withnell (Legal Information--Docket No. RM95-8-000), Office of the General Counsel, Federal Energy Regulatory Commission, 888 First Street NE., Washington, DC 20426, (202) 208-2063

Deborah B. Leahy (Legal Information--Docket No. RM94-7-001), Office of the General Counsel, Federal Energy Regulatory Commission, 888 First Street NE., Washington, DC 20426, (202) 208-2039

Michael A. Coleman (Technical Information), Office of Electric Power Regulation, Federal Energy Regulatory Commission, 888 First Street NE., Washington, DC 20426, (202) 208-1236.

SUPPLEMENTARY INFORMATION: In addition to publishing the full text of this document in the Federal Register, the Commission also provides all interested persons an opportunity to inspect or copy the contents of this document during normal business hours in the Public Reference Room at 888 First Street, NE., Washington, DC 20426.

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I. Introduction/Summary

Today the Commission issues three final, interrelated rules designed to remove impediments to competition in the wholesale bulk power marketplace and to bring more efficient, lower cost power to the Nation's electricity consumers.[1] The legal and policy cornerstone of these rules is to remedy undue discrimination in access to the monopoly owned transmission wires that control whether and to whom electricity can be transported in interstate commerce. A second critical aspect of the

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rules is to address recovery of the transition costs of moving from a monopoly-regulated regime to one in which all sellers can compete on a fair basis and in which electricity is more competitively priced.

In the year since the proposed rules were issued,[2] the pace of competitive changes in the electric utility industry

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[1] These rules are the rules on open access and stranded costs in the above dockets (*FERC Statutes and Regulations* ¶31,036), and an accompanying rule on Open Access Same-Time Information System and Standards of Conduct (OASIS Final Rule) (*FERC Statutes and Regulations* ¶31,037) being issued contemporaneously. The Commission also is issuing capacity reservation open access transmission tariffs in Docket No. RM96-11-000, *FERC Statutes and Regulations* ¶32,517. These final rules and proposed rule are being published concurrently in the *Federal Register*.

[2] On March 29, 1995, the Commission issued two notices of proposed rulemaking concerning open access transmission and stranded cost recovery. Promoting Wholesale Competition Through Open-Access Non-Discriminatory Transmission Service by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Notice of Proposed Rulemaking and Supplemental Notice of Proposed Rulemaking, 60 FR 17662 (April 7, 1995), *FERC Statutes and Regulations* ¶32,514 (1995). On December 13, 1995, the Commission issued a notice of proposed rulemaking on information systems. Real-Time Information Networks and Standards of Conduct, Notice of

has accelerated. By March of last year, 38 public utilities had filed wholesale open access transmission tariffs with the Commission. Today, prodded by such competitive changes and encouraged by our proposed rules, 106 of the approximately 166 public utilities that own, control, or operate[3] transmission facilities used in interstate commerce have filed some form of wholesale open access tariff. In addition, since the time the proposed rules were issued, numerous state regulatory commissions have adopted or are actively evaluating retail customer choice programs or other utility restructuring alternatives. These events have been spurred by continuing pressures in the marketplace for changes in the way electricity is bought, sold, and transported. Increasingly, customers are demanding the benefits of competition in the growing electricity commodity market.

The Commission estimates the potential quantitative benefits from the Final Rule will be approximately $3.8 to $5.4 billion per year of cost savings, in addition to the non-quantifiable benefits that include better use of existing assets and institutions, new market mechanisms, technical innovation, and less rate distortion. The continuing competitive changes in the industry and the prospect of these benefits to customers make it imperative that this Commission take the necessary steps within its jurisdiction to ensure that all wholesale buyers and sellers of electric energy can obtain non-discriminatory transmission access, that the

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Proposed Rulemaking, 60 FR 66182 (December 21, 1995), *FERC Statutes and Regulations* ¶32,516 (1995).

[3] The Commission's notice of proposed rulemaking in the above dockets proposed to apply the proposed requirements to public utilities that own and/or control facilities used for the transmission of electric energy in interstate commerce. "Own and/or control" is intended to include public utilities that "operate" facilities used for the transmission of electric energy in interstate commerce. However, we have modified the Final Rule regulatory text to remove any ambiguity.

transition to competition is orderly and fair, and that the integrity and reliability of our electricity infrastructure is maintained.

In this Rule, the Commission seeks to remedy both existing and future undue discrimination in the industry and realize the significant customer benefits that will come with open access. Indeed, it is our statutory obligation under sections 205 and 206 of the Federal Power Act (FPA) to remedy undue discrimination.

To do so, we must eliminate the remaining patchwork of closed and open jurisdictional transmission systems and ensure that all these systems, including those that already provide some form of open access, cannot use monopoly power over transmission to unduly discriminate against others. If we do not take this step now, the result will be benefits to some customers at the expense of others. We have learned from our experience in the natural gas area the importance of addressing competitive transition issues early and with as much certainty to market participants as possible.

Accordingly, in this proceeding and in the accompanying proceeding on OASIS, the Commission, pursuant to its authorities under sections 205 and 206 of the FPA:

- Requires all public utilities that own, control or operate facilities used for transmitting electric energy in interstate commerce

- To file open access non-discriminatory transmission tariffs that contain minimum terms and conditions of non-discriminatory service;

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- To take transmission service (including ancillary services) for their own new wholesale sales and purchases of electric energy under the open access tariffs;

- To develop and maintain a same-time information system that will give existing and potential transmission users the same access to transmission information that the public utility enjoys, and further requires public utilities to separate transmission from generation marketing functions and communications;

- Clarifies Federal/state jurisdiction over transmission in interstate commerce and local distribution and provides for deference to certain state recommendations; and

- Permits public utilities and transmitting utilities to seek recovery of legitimate, prudent and verifiable stranded costs associated with providing open access and FPA section 211 transmission services.

Open Access

The Final Rule requires public utilities to file a single open access tariff that offers both network, load-based service and point-to-point, contract-based service. The Rule contains a pro forma tariff that reflects modifications to the NOPR's proposed terms and conditions and also permits variations for regional practices. All public utilities subject to the Rule, including those that already have tariffs on file, will be required to make section 206 compliance filings to meet the new pro forma tariff non-price minimum terms and conditions of non-discriminatory transmission. Utilities may propose their own rates in a section 205 compliance filing.

The Rule provides that public utilities may seek a waiver of some or all of the requirements of the Final Rule. In addition, non-public utilities may seek a waiver of the tariff reciprocity provisions.

The Final Rule does not generically abrogate existing requirements contracts, but will permit customers and public utilities to seek modification, or termination, of certain existing requirements contracts on a case-by-case basis. As to coordination arrangements and contracts, the Rule finds that

these arrangements and contracts may need to be modified to remove unduly discriminatory transmission access and/or pricing provisions. Such arrangements and agreements include power pool agreements, public utility holding company agreements, and certain bilateral coordination agreements. The Rule provides guidance and timelines for modifying unduly discriminatory coordination arrangements and contracts, and specifies when the members of such arrangements must begin to conduct trade with each other using the same open access tariff offered to others. The Rule also provides guidance regarding the formation of independent system operators (ISOs).

The Rule does not require any form of corporate restructuring, but will accommodate voluntary restructuring that is consistent with the Rule's open access and comparability policies.

As discussed in the NOPR, not all owners or controllers of interstate transmission facilities are subject to the Commission's jurisdiction under sections 205 and 206 of the FPA and therefore are not subject to this Rule's open access requirements. Therefore, the Final Rule retains the proposed reciprocity provision in the pro forma tariff. Without such a provision, non-open access utilities could take advantage of the competitive opportunities of open access, while at the same time offering inferior access, or no access at all, over their own facilities. Thus, open access utilities would be unfairly burdened. We note that some non-jurisdictional utilities have expressed an interest in a mechanism for obtaining a Commission determination that their transmission tariffs satisfy the reciprocity provisions in the pro forma tariffs, and we provide such a mechanism in the Rule.

The Final Rule does not generically provide for market-based generation rates. Although the Rule codifies the Commission's prior decision that there is no generation dominance in new generating capacity, intervenors in cases

may raise generation dominance issues related to new capacity. In addition, to obtain market-based rates for existing generation, we will continue to require public utilities to show, on a case-by-case basis, that there is no generation dominance in existing capacity. Further, in all market-based rate cases, we will continue to look at whether an applicant and its affiliates could erect other barriers to entry and

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whether there may be problems due to affiliate abuse or reciprocal dealing.

Finally, contemporaneously with this Rule the Commission issues an NOPR on capacity reservation tariffs as an alternative, and perhaps superior, means of remedying undue discrimination.

Transmission/Local Distribution

The Rule clarifies the Commission's interpretation of the Federal/state jurisdictional boundaries over transmission and local distribution. While we reaffirm our conclusion that this Commission has exclusive jurisdiction over the rates, terms, and conditions of unbundled retail transmission in interstate commerce by public utilities, we nevertheless recognize the very legitimate concerns of state regulatory authorities as they contemplate direct retail access or other state restructuring programs. Accordingly, we specify circumstances under which we will give deference to state recommendations. Although jurisdictional boundaries may shift as a result of restructuring programs in wholesale and retail markets, we do not believe this will change fundamental state regulatory authorities, including authority to regulate the vast majority of generation asset costs, the siting of generation and transmission facilities, and decisions regarding retail service territories. We intend to be respectful of state objectives so long as they do not balkanize interstate

transmission of power or conflict with our interstate open access policies.

Stranded Costs

With regard to stranded costs, the Final Rule adopts the Commission's supplemental proposal. It will permit utilities to seek extra-contractual recovery of stranded costs associated with a limited set of existing (executed on or before July 11, 1994) wholesale requirements contracts and provides that the Commission will be the primary forum for utilities to seek recovery of stranded costs associated with retail-turned-wholesale transmission customers. It also will allow utilities to seek recovery of stranded costs caused by retail wheeling only in circumstances in which the state regulatory authority does not have authority to address retail stranded costs at the time the retail wheeling is required. The Rule retains the revenues lost approach for calculating stranded costs and provides a formula for calculating such costs.

Environmental Issues

The Commission has prepared a Final Environmental Impact Statement (FEIS) evaluating the possible environmental consequences of changes in the bulk power marketplace expected to occur as a result of the open access requirements of this Final Rule. The FEIS focuses, as do most commenters, on possible increases in emissions of nitrogen oxides (NO/X/) from certain fossil-fuel fired generators, which could affect air quality in the producing region and in areas to which these emissions may be carried.

In response to comments on the Draft EIS, the Commission performed numerous additional studies. The FEIS finds that the relative future competitiveness of coal and natural gas generation is the key variable affecting the impact of the Final Rule. If competitive conditions favor natural gas, the Rule is likely to lead to environmental benefits. Both EPA and the Commission staff believe this

projected scenario is the more likely one. If competitive conditions favor coal, the Rule may lead to small negative environmental impacts. However, even using the most extreme, unlikely assumptions about the future of the industry, the negative consequences are not likely to occur until after the turn of the century. Because the impacts will remain modest at least until 2010, there is no need for an interim mitigation program. In addition, even if the data showed more significant negative consequences requiring mitigation, the Commission does not have the statutory authority under the Federal Power Act or the expertise to address this possible far-term problem. The Commission believes, however, that there is time for federal and state air quality authorities to address any potential adverse impact as part of a comprehensive NO_x regulatory program under the Clean Air Act.[4]

Despite our conclusions regarding the lack of environmental impacts expected to result from the Rule, the Commission has examined a wide variety of proposals for mitigating possible adverse effects. We share the view of most commenters

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that the preferred approach for mitigating increased NO_x emissions generally is a NO_x cap and trading regulatory program comparable to that developed by Congress to address sulfur dioxide emissions in the Clean Air Act Amendments of 1990.[5] The Commission has examined various means of establishing such a program, including use of existing federal authorities under the Clean Air Act, cooperative efforts by state and federal air quality regulators, and development of a new emissions regulatory program administered by the Commission under the Federal Power

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4 42 U.S.C. §§7401, *et seq.*

5 42 U.S.C.A. §7651b-e.

Act. The Commission has concluded that a NO_x regulatory program could best be developed and administered under the Clean Air Act, in cooperation with interested states, and offers to lend Commission support to that effort should it become necessary.

Conclusion

The Commission believes that the Final Rule will remedy undue discrimination in transmission services in interstate commerce and provide an orderly and fair transition to competitive bulk power markets.

II. Public Reporting Burden

The Open Access Final Rule and the Stranded Cost Final Rule specify filing requirements to be followed by public utilities that own, control or operate transmission facilities in interstate commerce in making non-discriminatory open access tariff filings and filings to recover legitimate, prudent and verifiable stranded costs. The information collection requirements of the final rules are attributable to FERC-516 "Electric Rate Filings." The current total annual reporting burden for FERC-516 is 828,300 hours.

A. Docket No. RM95-8-000 (Open Access Final Rule)

The Open Access Final Rule requires public utilities filing non-discriminatory open access tariffs to provide certain information to the Commission. The Commission estimated that the public reporting burden for the information collection would average 300 hours per response. This estimate included time for reviewing the requirements of the Commission's regulations, searching existing data sources, gathering and maintaining the necessary data, completing and reviewing the collection of information, and filing the revised information. No comments on the burden estimate were received. Because the Final Rule adopts essentially the same information requirements that are contained in the proposed

rule, we believe that the average filing burden is same for the Final Rule.

In the proposed rule, the Commission noted that there are approximately 328 public utilities, including marketers and wholesale generation entities. We initially estimated that 137 public utilities own, control or operate facilities used for the transmission of electric energy in interstate commerce, and would be subject to the filing requirements of the proposed rule. Upon further review, the Commission believes that approximately 166 public utilities will respond to the information collection. Accordingly, the public reporting burden is estimated to be 49,800 hours.

B. Docket No. RM94-7-001 (Stranded Cost Final Rule)

In the supplemental notice of proposed rulemaking, the Commission estimated that the information requirements of the proposed rule would not differ substantially from those contained in the initial proposed rule. In that notice, the Commission estimated that the public reporting burden for the information requirements contained in the proposed rule would be 50 hours per response with 10 responses annually. No comments on this filing burden were received. The information requirements adopted in the Stranded Cost Final Rule are not substantially different from those in the proposed rule. Therefore, the Commission concludes that there will be no additional public filing burden associated with the Stranded Cost Final Rule.

III. Background

In the NOPR, we set out a detailed statement of the events leading up to this rulemaking. We repeat that background here, updated to reflect what has happened since March 1995, and discuss why it is necessary to undertake regulatory reform in the electric industry at this time. We do so to provide the necessary

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backdrop to our action in adopting this Rule.

A. Structure of the Electric Industry at Enactment of Federal Power Act

The Federal Power Act was enacted in an age of mostly self-sufficient, vertically integrated electric utilities, in which generation, transmission, and distribution facilities were owned by a single entity and sold as part of a bundled service (delivered electric energy) to wholesale and retail customers. Most electric utilities built their own power plants and transmission systems, entered into interconnection and coordination arrangements with neighboring utilities, and entered into long-term contracts to make wholesale requirements sales (bundled sales of generation and transmission) to municipal, cooperative, and other investor-owned utilities (IOUs) connected to each utility's transmission system. Each system covered limited service areas. This structure of separate systems arose naturally due primarily to the cost and technological limitations on the distance over which electricity could be transmitted.

Through much of the 1960s, utilities were able to avoid price increases, but still achieve increased profits, because of substantial increases in scale economies, technological improvements, and only moderate increases in input prices.[6] Thus, there was no pressure on regulatory commissions to use regulation to affect the structure of the industry.[7]

B. Significant Changes in the Electric Industry

In the late 1960s and throughout the 1970s, a number of significant events occurred in the electric industry that changed the perceptions of utilities and began a shift to a

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6 Paul L. Joskow, Inflation and Environmental Concern: Structural Change in the Process of Public Utility Regulation, 17 J. Law & Econ. 291, 312 (1974); *see also* Charles F. Phillips, Jr., *The Regulation of Public Utilities* 11 (1988).

7 *See* Joskow, *supra* at p. 312; *see also* Phillips, *supra* at p. 12.

more competitive marketplace for wholesale power.[8] This was the beginning of periods of rapid inflation, higher nominal interest rates, and higher electricity rates.[9] During this time, consumers became concerned about higher electricity rates and questioned any price increases filed by utilities.[10]

During this same time frame, the construction of nuclear and other capital-intensive baseload facilities--actively encouraged by federal and some state governments--contributed to the continuing cost increases and uncertainties in the industry.[11] These investments were made based on the assumptions that there would be steady increases in the demand for electricity and continued large increases in the price of oil.[12] However, due to conservation and economic downturns, the expected demand increases did not materialize. Load growth virtually disappeared in some areas, and many utilities unexpectedly found themselves with excess capacity.[13] In addition, by the 1980s, the oil cartel collapsed, with a resulting glut of low-priced oil.[14] At the same time, inflation substantially increased the costs of these

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8 *See* Joskow, *supra* at p. 312; *see also* Phillips, *supra* at pp. 12-13.

9 *See* Joskow, *supra* at pp. 312-13; *see also* Phillips, *supra* at p. 13. The Arab oil embargo resulted in significantly higher oil prices through the 1970s. *See* Richard J. Pierce, Jr., The Regulatory Treatment of Mistakes in Retrospect: Canceled Plants and Excess Capacity, 132 U. Pa. L. Rev. 497, 501 (1984).

10 *See* Joskow, *supra* at p. 313; *see also* Phillips, *supra* at p. 13.

11 *See generally Jersey Central Power & Light Company v. FERC*, 810 F.2d 1168, 1171 (D.C. Cir. 1987).

12 *Id.*

13 *See* Pierce, *supra* at p. 503. By 1983, the Department of Energy had estimated that the sunk costs for canceled nuclear plants alone amounted to $10 billion. *Id.* at p. 498.

14 *Id.*

large baseload generating plants.[15] Surging interest rates further increased the cost of the capital needed to finance and capitalize these projects and completion schedules were significantly

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extended by, in part, more stringent safety and environmental requirements.[16]

As a result, expensive large baseload plants for which there was little or no demand, came onto the market or were in the process of being constructed. Accordingly, between 1970 and 1985, average residential electricity prices more than tripled in nominal terms, and increased by 25% after adjusting for general inflation.[17] Moreover, average electricity prices for industrial customers more than quadrupled in nominal terms over the same period and increased 86% after adjusting for inflation.[18] The rapidly increasing rates for electric power during this period,

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[15] *See* Bernard S. Black & Richard J. Pierce, Jr., The Choice Between Markets and Central Planning in Regulating the U.S. Electricity Industry, 93 Col. L. Rev. 1339, 1346 (1993) ("Actual costs of nuclear power plants vastly exceeded estimates, sometimes by as much as 1000%.").

[16] *See* Phillips, *supra* at p. 13. Fossil fuel-fired plants became subject to increased regulation as a result of the Clean Air Act of 1970, and its 1977 amendments. 42 U.S.C. §§7401-7642. In 1971, nuclear plant licensing became subject to the environmental impact statement requirements of the National Environmental Policy Act of 1969. 42 U.S.C. §4332. Following the 1979 accident at the Three Mile Island nuclear plant, nuclear plants also became subject to additional safety regulations, resulting in higher costs. *See* Energy Information Administration, *The Changing Structure of the Electric Power Industry 1970-1991* (March 1993) 35. Between 1976 and 1980, most states and many localities instituted laws governing power plant siting.

[17] Based on retail prices reported in Energy Information Administration (EIA), Monthly Energy Review, January 1995, Table 9.9 (Prices adjusted for inflation using the GDP Deflator (1987 = 100)).

[18] *Id.*

together with the opportunities provided by the Public Utility Regulatory Policies Act of 1978 (PURPA) (discussed *infra*), also prompted some industrial customers to bypass utilities by constructing their own generation facilities. This further exacerbated rate increases for remaining customers--primarily residential and commercial customers.

Consumers responded to these "rate shocks" by exerting pressure on regulatory bodies to investigate the prudence of management decisions to build generating plants, especially when construction resulted in cost overruns, excess capacity, or both. Between 1985 and 1992, writeoffs of nuclear power plants totalled $22.4 billion.[19] These writeoffs significantly reduced the earnings of the affected utilities.[20] Delays in obtaining rate increases to reflect the effects of inflation further reduced investor returns. Thus, many utilities became reluctant to commit capital to long-term construction decisions involving large scale generating plants.[21]

In addition to economic changes in the industry, significant technological changes in both generation and transmission have occurred since 1935. Through the 1960s, bigger was cheaper in the generation sector and the industry was able to capitalize on economies of scale to produce power at lower per-unit costs from larger and larger plants.[22] As a result, large utility companies that could finance and

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19 *See* Black & Pierce, *supra* at p. 1346 (These writeoffs were "about 17% of the book value of total 1992 utility investment.").

20 *Id.*

21 *Id.* ("The high perceived risk of future disallowances reversed utilities' incentives to overinvest, and made utilities extremely reluctant to build new power plants.").

22 *See* Preston Michie, Billing Credits for Conservation, Renewable, and Other Electric Power Resources: an Alternative to Marginal-Cost-Based Power Rates in the Pacific Northwest, 13 Environmental Law 963, 964-65 (1983).

manage construction projects of larger scale had a price advantage over smaller utility companies and customers who might otherwise have considered building their own generating units. Scale economies encouraged power generation by large vertically-integrated utility companies that also transmitted and distributed power. Beginning in the 1970s, however, additional economies of scale in generation were no longer being achieved.[23] A significant factor was that larger generation units were found to need relatively greater maintenance and experience longer downtimes.[24] The electric

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industry faced the situation "where the price of each incremental unit of electric power exceeded the average cost."[25] Bigger was no longer better.

Further dictating against larger generation units were advances in technologies that allowed scale economies to be exploited by smaller size units, thereby allowing smaller new plants to be brought on line at costs below those of the large plants of the 1970s and earlier. Such new technologies include combined cycle units and conventional steam units that use circulating fluidized bed boilers.[26]

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23 *Id.* at p. 965.

24 Energy Information Administration, *The Changing Structure of the Electric Power Industry 1970- 1991* (March 1993) 37 ("As larger units were constructed, however, utilities discovered that downtime was as much as 5 times greater for units larger than 600 megawatts than for units in the 100-megawatt range.")

25 *Id.; see also* George A. Perrault, Downsizing Generation: Utility Plans for the 1990s, Pub. Util. Fort. 15-16 (Sept. 27, 1990) ("The large base-load generating units that form the backbone of utility systems are almost totally absent from capacity plans for the 1990s.").

26 "From 1982 through 1991, the average capacity of fluidized-bed units increased rapidly to 72 megawatts for 4 units in 1991. The average capacity for the 19 units planned to begin operating in 1992 through 1995

The combined cycle generating plants generally use natural gas as their primary fuel. This technology has been made possible by the development of more efficient gas turbines, shorter construction lead times, lower capital costs, increased reliability, and relatively minimal environmental impacts.[27] Similarly, the circulating fluidized bed combustion boilers, fueled by coal and other conventional fuels, provide a more efficient and less polluting resource.

Today, "the optimum size [of generation plants] has shifted from [more than 500 MW] (10-year lead time) to smaller units (one-year lead time) [in the 50- to 150-MW range]."[28] Indeed, smaller and more efficient gas-fired combined-cycle generation facilities can produce power on the grid at a cost ranging from 5 cents per kWh to less than 3 cents per kWh.[29] This is significantly less than the costs for large plants constructed and installed by utilities over the last decade, which were typically in the range of 4 to 7 cents per kWh for coal plants and 9 to 15 cents for nuclear plants.[30]

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increases to 83 megawatts." Energy Information Administration, *The Changing Structure of the Electric Power Industry 1970-1991* (March 1993) 38.

[27] *See* Charles E. Bayless, Less is More: Why Gas Turbines Will Transform Electric Utilities, Pub. Util. Fort. (Dec. 1, 1994) 21.

[28] *Id.* at p. 24. *See also* Wallace E. Brand, Is Bigger Better? Market Power in Bulk Power Supply: From FDR to NOPR, Pub. Util. Fort. (Feb. 15, 1996) 23 at p. 25 (while the optimal baseload unit size is about 500 MW for coal-fired steam turbines, the optimal size for gas fired combined-cycle units is about 150 to 200 MW).

[29] FERC staff calculations based in part on combined-cycle plant cost data reported in 1994 FERC Form No. 1 for a sample of units placed in service during 1990-94. Costs vary with regional fuel and construction costs, among other reasons.

[30] Coal and Nuclear plant cost data reported in 1994 FERC Form No. 1 and the EIA report, *Electric Plant Cost and Power Production Expenses 1991*, 1993 DOE/EIA-0455(91), for plants placed in service during 1986-94; *see also* The 1994 Electric Executives' Forum, Bakke

Significant changes have also occurred in the transmission sector of the industry. Technological advances in transmission have made possible the economic transmission of electric power over long distances at higher voltages.[31] This has made it technically feasible for utilities with lower cost generation sources to reach previously isolated systems where customers had been captive to higher cost generation. In addition, the nature and magnitude of coordination transactions[32] have changed dramatically since enactment of the FPA, allowing increased coordinated operations and reduced reserve margins. Substantial amounts of electricity now move between regions, as well as between utilities in the same region. Physically isolated systems have become a thing of the past.

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C. The Public Utility Regulatory Policies Act and the Growth of Competition

In enacting PURPA,[33] Congress recognized that the rising costs and decreasing efficiencies of utility-owned generating facilities were increasing rates and harming the

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(President and CEO of the AES Corporation), Pub. Util. Fort. (June 1, 1994) 45 ("New generation can be built at about 3 cents per kilowatt-hour (U.S. average). Old generation costs about twice that * * *").

31 *See* Black & Pierce, *supra* at p. 1345 (In the late 1960s and 1970s, improved transmission efficiency and development of regional transmission networks "made it possible to build power plants up to 1000 miles from power users.").

32 Coordination transactions are voluntary sales or exchanges of specialized electricity services that allow buyers to realize cost savings or reliability gains that are not attainable if they rely solely on their own resources. For sellers, these transactions provide opportunities to earn additional revenue, and to lower customer rates, from capacity that is temporarily excess to native load capacity requirements.

33 Pub. L. No. 95-617, 92 Stat. 3117 (codified in U.S.C. sections 15, 16, 26, 30, 42, and 43).

economy as a whole.[34] To lessen dependence on expensive foreign oil, avoid repetition of the 1977 natural gas shortage, and control consumer costs, Congress sought to encourage electric utilities to conserve oil and natural gas.[35] In particular, Congress sanctioned the development of alternative generation sources designated as "qualifying facilities" (QFs) as a means of reducing the demand for traditional fossil fuels.[36] PURPA required utilities to purchase power from QFs at a price not to exceed the utility's avoided costs and to sell backup power to QFs.[37]

PURPA specifically set forth limitations on who, and what, could qualify as QFs. In addition to technological and size criteria, PURPA set limits on who could own QFs.[38]

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[34] *See generally FERC v. Mississippi*, 456 U.S. 742, 745-46 (1982).

[35] The Power Plant and Industrial Fuel Use Act of 1978. Pub. L. No. 95-617, 92 Stat. 3117 (codified in U.S.C. sections 15, 16, 26, 30, 42, and 43).

[36] QFs include certain cogenerators and small power producers. PURPA also added sections 210, 211, and 212 to the FPA, providing the Commission with authority to approve applications for interconnections and, in limited circumstances, wheeling. However, under section 211, as enacted in PURPA, the Commission could approve an applicati for wheeling only if it found, *inter alia*, that the order "would reasonably preserve existing competitive relationships." Because of this and other limitations in sections 211 and 212 as originally enacted, the provision was virtually ineffective. Only one section 211 order was ever issued pursuant to the original provision, and it was pursuant to a settlement. *See Public Service Company of Oklahoma*, 38 FERC ¶61,050 (1987). As discussed *infra*, section 211 was subsequently revised by the Energy Policy Act of 1992.

[37] 456 U.S. at p. 750. Congress recognized that encouragement was needed in part because utilities had been reluctant to purchase electric power from, and sell power to, nonutility generators. *Id.* at pp. 750-51.

[38] For example, PURPA provided that a cogeneration facility or small power production facility could not be owned by a person primarily engaged in the generation or sale of electric power (other than from

Notwithstanding these limitations, QFs proliferated. In 1989, there were 576 QF facilities. By 1993, there were more than 1,200 such facilities.[39] For the same time period, installed QF capacity increased from 27,429 megawatts to 47,774 megawatts.[40] The rapid expansion and performance of the QF industry demonstrated that traditional, vertically integrated public utilities need not be the only sources of reliable power.

During this period, the profile of generation investment began to change, and a market for non-traditional power supply beyond the purchases required by PURPA began to emerge. QFs were limited to cogenerators and small power producers.[41]

However, other non-traditional power producers who could not meet the QF criteria began to build new capacity to compete in bulk power markets, without such PURPA benefits as the mandatory purchase requirements. These producers, known as independent power producers (IPPs),

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cogeneration or small power production facilities). *See* 16 U.S.C. §§ 796(17) and (18).

39 Energy Information Administration, *Electric Power Annual 1993* (December 1994) 124 (Table 77).

40 *Id.* EIA data for 1989 through 1991 was for facilities of 5 megawatts or more and for 1992 and 1993 was for facilities of 1 megawatt or more. A comparison with Table 74 on page 121 for the years 1992 and 1993 reveals that this mixing of data bases is likely of minimal effect.

41 Generally, the law has imposed an 80 MW cap on small power producers. A limited exception enacted in 1990 permitted small power facilities that could exceed 80 MW and still qualify as QFs under PURPA. This exception was limited to certain solar, wind, waste, and geothermal small power production facilities and only covered applications for certification of facilities as qualifying small power production facilities that were submitted no later than December 31, 1994 and for which construction commences no later than December 31, 1999. See Solar, Wind, Waste, and Geothermal Power Production Incentives Act of 1990, Pub. L. No. 101-575, 104 Stat. 2834 (1990), *amended*, Pub. L. No. 102-46, 105 Stat. 249 (1991).

were predominantly single-asset generation companies that did not own any transmission or distribution facilities. While traditional utilities were generally

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reluctant at that time to invest in new generating facilities under cost of service regulation, utilities increasingly became interested in participating in this new generation sector. They organized affiliated power producers (APPs), with assets not included in utility rate base, and sought to sell power in their own service territories and the territories of other utilities. At the same time, power marketers arose. These entities--owning no transmission or generation--buy and sell power.[42]

There were two major impediments to the development of IPPs and APPs. First, the ownership restrictions of the Public Utility Holding Company Act (PUHCA)[43] severely inhibited these new entities from entering the generation business.[44] Second, these entities needed transmission service in order to compete in electricity markets.

While the Commission had no authority to remove PUHCA restrictions,[45] it encouraged the development of IPPs and APPs, as well as emerging power marketers, by authorizing market-based rates for their power sales on a

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[42] The first power marketer in the electric industry was Citizens Energy Corporation. *See Citizens Energy Corporation*, 35 FERC ¶61,198 (1986). Power marketers take title to electric energy. Power brokers, on the other hand, do not take title and are limited to a matchmaking role.

[43] 15 U.S.C. §79 *et seq.*

[44] As discussed *infra*, Congress eventually provided a means to avoid the PUHCA restrictions by creating exempt wholesale generators (EWGs) in the Energy Policy Act.

[45] The industry was successful to some extent in developing ownership structures that permitted such investment. *See, e.g., Commonwealth Atlantic Limited Partnership*, 51 FERC ¶61,368, at p. 62,240 and n.20 (1990).

case-by-case basis and by encouraging more widely available transmission access. From 1989 through 1993, facilities owned by IPPs and other non-traditional generators (other than QFs) increased from 249 to 634 and their installed capacity increased from 9,216 megawatts to 13,004 megawatts.[46] Indeed, "[i]n 1992, for the first time, generating capacity added by independent producers exceeded capacity added by utilities."[47]

Market-based rates helped to develop competitive bulk power markets. A generating utility allowed to sell its power at market-based rates could move more quickly to take advantage of short-term or even long-term market opportunities than those laboring under traditional cost-of-service tariffs, which entail procedural delays in achieving tariff approvals and changes.

In approving these market-based rates, the Commission required, *inter alia*, that the seller and any of its affiliates lack market power or mitigate any market power that they may have possessed.[48] The major concern of the Commission was whether the seller or its affiliates could limit competition and thereby drive up prices. A key inquiry became whether the seller or its affiliates owned or controlled transmission facilities in the relevant service area and therefore, by denying access or imposing discriminatory terms or conditions on transmission service, could foreclose other

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46 Energy Information Administration, *Electric Power Annual 1993* (December 1994) 124 (Table 77).

47 Black & Pierce, *supra* at p. 1349 n.25.

48 *See, e.g., Ocean State Power*, 44 FERC ¶61,261 (1988); *Commonwealth Atlantic Limited Partnership*, 51 FERC ¶61,368 (1990); *Citizens Power & Light Company*, 48 FERC ¶61,210 (1989); *Orange and Rockland Utilities, Inc.*, 42 FERC ¶61,012 (1988); *Doswell Limited Partnership*, 50 FERC ¶61,251 (1990) (*Doswell*); and *Dartmouth Power Associates Limited Partnership*, 53 FERC ¶61,117 (1990).

generators from competing.[49] As we have previously explained:

The most likely route to market power in today's electric utility industry lies through ownership or control of transmission facilities. Usually, the source of market power is dominant or exclusive *ownership* of the facilities. However, market power also may be gained without ownership. Contracts can confer the same rights of control. Entities with contractual control over transmission facilities can withhold supply and extract monopoly prices just as effectively as those who control facilities through ownership.[50]

As entry into wholesale power generation markets increased, the ability of customers to gain access to the transmission services necessary to reach competing

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suppliers became increasingly important.[51] In addition, beginning in the late 1980s, in order to mitigate their market

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[49] *See, e.g., Doswell*, 50 FERC at p. 61,757.

[50] *Citizens Power & Light Corporation*, 48 FERC ¶61,210, at p. 61,777 (1989) (emphasis in original); *see also Utah Power & Light Company, PacifiCorp and PC/UP&L Merging Corporation*, 45 FERC ¶61,095, at pp. 61,287-89 (1988), *order on reh'g*, 47 FERC ¶61,209, *order on reh'g*, 48 FERC ¶61,035 (1989), *remanded in part sub nom. Environmental Action, Inc. v. FERC*, 939 F.2d 1057 (D.C. Cir. 1991), *order on remand*, 57 FERC ¶61,363 (1991).

[51] In earlier years, a few customers were able to obtain access as a result of litigation, beginning with the Supreme Court's decision in *Otter Tail Power Company v. United States*, 410 U.S. 366 (1973). Additionally, some customers gained access by virtue of Nuclear Regulatory Commission license conditions and voluntary preference power transmission arrangements associated with federal power marketing agencies. *See, e.g., Consumers Power Company*, 6 NRC 887, 1036-44 (1977) and *The Toledo Edison Company and Cleveland Electric Illuminating Company*, 10 NRC 265, 327-34 (1979). *See Florida Municipal Power Agency v. Florida Power and Light Company*, 839 F. Supp. 1563 (M.D. Fla. 1993). *See also* Electricity Transmission:

power to meet Commission conditions, public utilities seeking Commission approval of mergers or consolidations under section 203 of the FPA or Commission authorization for blanket approval of market-based rates for generation services under section 205 of the FPA, filed "open access" transmission tariffs of general applicability.[52] The Commission applied its market rate analysis to IOUs, as well as IPPs, APPs, and marketers, and allowed IOUs to sell at market-based rates only if they opened their transmission systems to competitors.[53] The Commission also approved proposed mergers on the condition that the merging companies remedy anticompetitive effects potentially caused by the merger by filing "open access" tariffs. These early "open access" tariffs required only that the companies provide point-to-point transmission services, which is a much narrower requirement than that being imposed in this Rule and did not require transmission owners to provide to others the same quality of service that they themselves enjoyed.

Realities, Theory and Policy Alternatives, The Transmission Task Force Report to the Commission, October 1989, 197.

52 *See, e.g., Public Service Company of Colorado*, 59 FERC ¶61,311 (1992), *reh'g denied*, 62 FERC ¶61,013 (1993); *Utah Power & Light Company, et al.*, Opinion No. 318, 45 FERC ¶61,095 (1988), *order on reh'g*, Opinion No. 318-A, 47 FERC ¶61,209 (1989), *order on reh'g*, Opinion No. 318-B, 48 FERC ¶61,035 (1989), *aff'd in relevant part sub nom. Environmental Action Inc. v. FERC*, 939 F.2d 1057 (D.C. Cir. 1991); *Northeast Utilities Service Company (Public Service Company of New Hampshire)*, Opinion No. 364-A, 58 FERC ¶61,070, *reh'g denied*, Opinion No. 364-B, 59 FERC ¶61,042, *order granting motion to vacate and dismissing request for rehearing*, 59 FERC ¶61,089 (1992), *affirmed in relevant part sub nom. Northeast Utilities Service Company v. FERC*, 993 F.2d 937 (1st Cir. 1993).

53 *See, e.g., Public Service of Indiana, Inc.*, 51 FERC ¶61,367 (1990), *reh'g denied*, 52 FERC ¶61,260 (1990), *appeal dismissed sub nom. Northern Indiana Public Service Company v. FERC*, 954 F.2d 736 (D.C.Cir. 1992).

Following PURPA, the economic and technological changes in the transmission and generation sectors helped give impetus to the many new entrants in the generating markets who could sell electric energy profitably with smaller scale technology at a lower price than many utilities selling from their existing generation facilities at rates reflecting cost. However, it became increasingly clear that the potential consumer benefits that could be derived from these technological advances could be realized only if more efficient generating plants could obtain access to the regional transmission grids. Because many traditional vertically integrated utilities still did not provide open access to third parties and still favored their own generation if and when they provided transmission access to third parties, barriers continued to exist to cheaper, more efficient generation sources.

D. The Energy Policy Act

In response to the competitive developments following PURPA, and the fact that PUHCA and lack of transmission access remained major barriers to new generators, Congress enacted Title VII of the Energy Policy Act of 1992 (Energy Policy Act).[54] A goal of the Energy Policy Act was to promote greater competition in bulk power markets by encouraging new generation entrants, known as exempt wholesale generators (EWGs), and

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by expanding the Commission's authority under sections 211 and 212 of the FPA to approve applications for transmission services.[55]

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[54] Pub. L. No. 102-486, 106 Stat. 2776 (1992), codified at, among other places, 15 U.S.C. §79z-5a and 16 U.S.C. §§796 (22-25), 824j-l.

[55] *See El Paso Electric Company and Central and South West Services Inc.*, 68 FERC ¶61,181, at p. 61,914 (1994) *(CSW)*; *see also* Paul Kemezis, FERC's Competitive Muscle: The Comparability Standard,

An EWG is defined as

Any person determined by the Federal Energy Regulatory Commission to be engaged directly, or indirectly through one or more affiliates as defined in [PUHCA] section 2(a)(11)(B), and exclusively in the business of owning or operating, or both owning and operating, all or part of one or more eligible facilities and selling electric energy at wholesale.[56]

If the Commission, upon an application, determines that a person is an EWG, that person will be exempt from PUHCA.[57] This provision removed a significant impediment to the development of IPPs and APPs by allowing them to develop projects as EWGs free from the strictures of PUHCA or the QF PURPA limitations.

While sections 211 and 212, as enacted by PURPA, were intended to provide greater access to the transmission grid, the limitations placed on these sections made them unusable in virtually all circumstances.[58] However, as amended by the Energy Policy Act, these sections now give the Commission broader authority to order transmitting utilities to provide wholesale transmission services, upon application, to any electric utility, Federal power marketing agency, or any other person generating electric energy for sale for resale.

The Energy Policy Act also added section 213 to the FPA. Section 213(a) requires a transmitting utility that does not agree to provide wholesale transmission service in accordance with a good faith request to provide a written

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Electrical World 45 (Jan.1995) ("In EPAct, Congress made it clear that the electric-power industry was to move toward a fully competitive market system, but left most of the implementation to FERC.").

56 15 U.S.C. §79z-5a.

57 15 U.S.C. §79z-5a(e).

58 *See supra* note 36.

explanation of its proposed rates, terms, and conditions and its analysis of any physical or other constraints.[59] Section 213(b) required the Commission to enact a rule requiring transmitting utilities to submit annual information concerning potentially available transmission capacity and known constraints.[60]

E. The Present Competitive Environment

Following the Energy Policy Act, the Commission established rules: (1) For certain generators to obtain EWG status and thus an exemption from PUHCA;[61] and (2) that required transmission information availability. The Commission also pursued a number of initiatives aimed at fostering the development of more competitive bulk power markets, including aggressive implementation of section 211,

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[59] *See* Policy Statement Regarding Good Faith Requests for Transmission Services and Responses by Transmitting Utilities Under Sections 211(a) and 213(a) of the Federal Power Act, as Amended and Added by the Energy Policy Act of 1992, 58 FR 38964 (July 21, 1993), *FERC Statutes and Regulations* ¶30,975 (1993) (Policy Statement Regarding Good Faith Requests for Transmission Services).

[60] *See* New Reporting Requirements Implementing Section 213(b) of the Federal Power Act and Supporting Expanded Regulatory Responsibilities Under the Energy Policy Act of 1992, and Conforming and Other Changes to Form No. FERC-714, 58 FR 52420 (October 8, 1993), *FERC Statutes and Regulations* ¶30,980 (Order No. 558), *reh'g denied*, Order No. 558-A, 65 FERC ¶61,324 (1993), *regulations modified*, 59 FR 15333 (April 1, 1994), *FERC Statutes and Regulations* ¶30,993.

[61] *See* Order No. 550, Filing Requirements and Ministerial Procedures for Persons Seeking Exempt Wholesale Generator Status, 58 FR 8897 (February 18, 1993), *FERC Statute and Regulations* ¶30,964, *order on reh'g*, Order No. 550-A, 58 FR 21250 (April 20, 1993), *FERC Statutes and Regulations* ¶30,969 (1993). As recognized by Congress and the Commission, availability of transmission information is critical in developing competitive markets. See *supra* notes 59 and 60. This opened the "black box" of information that previously was available only to transmission owners.

a new look at undue discrimination under the FPA, easing of market entry for sellers of generation from new facilities, and initiation of a number of industry-wide reforms. As stated by the Commission, in recognition of the Congressional goal in

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the Energy Policy Act of creating competitive bulk power markets:

Our goal is to facilitate the development of competitively priced generation supply options, and to ensure that wholesale purchasers of electric energy can reach alternative power suppliers and vice versa.[62]

1. Use of Sections 211 and 212 to Obtain Transmission Access

The Commission has aggressively implemented sections 211 and 212 of the FPA, as amended by the Energy Policy Act, in order to promote competitive markets.[63] When wheeling requests under sections 211 and 212 have been made, the Commission has required wheeling in almost all of the requests it has processed. To date, the Commission has issued orders (proposed or final) requiring wheeling in 12 of the 14 cases it has acted on.[64]

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62 *See* Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Notice of Proposed Rulemaking, 59 FR 35274 (July 11, 1994), *FERC Statutes and Regulations* ¶32,507, at p. 32,866 (Stranded Cost NOPR); *American Electric Power Service Corporation*, 67 FERC ¶61,168, *clarified*, 67 FERC ¶61,317 (1994).

63 16 U.S.C.A. §§824j-824k (West 1985 and Supp. 1994).

64 *See, e.g.*, final orders issued in *City of Bedford*, 68 FERC ¶61,003 (1994), *reh'g denied*, 73 FERC ¶61,322 (1995); *Florida Municipal Power Agency v. Florida Power & Light Company*, 67 FERC ¶61,167 (1994), *order on reh'g*, 74 FERC ¶61,006 (1996); *Minnesota Municipal Power Agency*, 68 FERC ¶61,060 (1994); and *Tex-La Electric Cooperative of Texas*, 69 FERC ¶61,269 (1994); *see also* Appendix A.

As a general matter, section 211 has permitted some inroads to be made by customers in obtaining transmission service from public utilities that historically have declined to provide access to their systems, or have offered service only on a discriminatory basis. Under section 211, the Commission has granted requests for the broader type of service that most utilities historically have refused to provide--network service. Although transmission owners have provided limited amounts of unbundled point-to-point transmission service, third-party customers have not been able to obtain the flexibility of service that transmission owners enjoy.

In *Florida Municipal*, a section 211 case, the Commission ordered "network," rather than the narrower "point-to-point," service.[65] Network service permits the applicant to fully integrate load and resources on an instantaneous basis in a manner similar to the transmission owner's integration of its own load and resources. At the same time, the Commission made the generic finding that the availability of transmission service will enhance competition in the market for power supplies and lead to lower costs for consumers. The Commission explained that as long as the transmitting utility is fully and fairly compensated and there

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[65] *See Florida Municipal Power Agency v. Florida Power & Light Company*, 65 FERC ¶61,125, *reh'g dismissed*, 65 FERC ¶61,372 (1993), *final order*, 67 FERC ¶61,167 (1994), *order on reh'g*, 74 FERC ¶61,006 (1996). The Commission has "characterized point-to-point service as involving designated points of entry into and exit from the transmitting utility's system, with a designated amount of transfer capability at each point." *El Paso Electric Company v. Southwestern Public Service Company*, 68 FERC ¶61,182, at p. 61,926 n.9 (1994) (*citing Entergy Services, Inc.*, 58 FERC ¶61,234, at p. 61,768 (1993), *reh'g dismissed*, 68 FERC ¶61,399 (1994)). Network service allows more flexibility by allowing a transmission customer to use the entire transmission network to provide generation service for specified resources and specified loads without having to pay multiple charges for each resource-load pairing.

is no unreasonable impairment of reliability, transmission service is in the public interest.[66]

As discussed *infra*, based on the mounting competitive pressures in the industry and rapidly evolving markets, we have concluded that section 211 alone is not enough to eliminate undue discrimination. The comments received on the proposed rules, discussed in detail *infra*, confirm this conclusion. The significant time delays involved in filing an individual service request for bilateral service under section 211 place the customer at a severe disadvantage compared to the transmission owner and can result in discriminatory treatment in the use of the transmission system. It is an inadequate procedural substitute for readily available service under a filed non-discriminatory open access tariff. As the Commission noted in *Hermiston Generating Com-*

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pany, "[t]he ability to spend time and resources litigating the rates, terms and conditions of transmission access is not equivalent to an enforceable voluntary offer to provide comparable service under known rates, terms and conditions."[67]

2. Commission's Comparability Standard

In the Spring of 1994, the Commission began to address the problem of the disparity in transmission service that utilities provided to third parties in comparison to their own uses of the transmission system. In the seminal case in this area, *American Electric Power Service Corporation* (*AEP*), the company voluntarily proposed a tariff of general applicability that would offer firm, point-to-point

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66 *Florida Municipal*, 67 FERC at p. 61,477.

67 69 FERC ¶61,035, at p. 61,165 (1994), *reh'g denied*, 72 FERC ¶61,071 (1995); *see also Southwest Regional Transmission Association*, 69 FERC ¶61,100, at p. 61,398 (1994), *order on compliance filing*, 73 FERC ¶61,147 (1995) (*SWRTA*).

transmission service for a minimum of one month.[68] The Commission accepted the proposed transmission tariff for filing and suspended its effectiveness for one day, subject to refund.[69] Rehearing requests challenged the Commission's summary approval of the restriction of service to point-to-point as being discriminatory and anticompetitive.[70] The rehearing requests argued that the tariff should be expanded to include network services such as those used by the transmission owner. On rehearing, the Commission announced a new standard for evaluating claims of undue discrimination.

The Commission found that a voluntarily offered, new open access transmission tariff that did not provide for services comparable to those that the transmission owner provided itself was unduly discriminatory and anticompetitive.[71] In reaching that conclusion, the Commission broadened its undue discrimination analysis (which traditionally had focused on the rates, terms, and

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[68] 64 FERC ¶61,279 (1993), *reh'g granted*, 67 FERC ¶61,168, *clarified*, 67 FERC ¶61,317 (1994).

[69] The Commission explained that AEP could limit the service it was offering because it was "providing the service voluntarily under a tariff of general applicability." 64 FERC at p. 62,978.

[70] *AEP*, 67 FERC at p. 61,489.

[71] With respect to anticompetitive effects, the Commission explained that it has "adhered to the Supreme Court's determination that the Commission's 'important and broad regulatory power * * * carries with it the responsibility to consider, in appropriate circumstances, the anticompetitive effects of regulated aspects of interstate utility operations pursuant to sections 202 and 203, and under like directives contained in sections 205, 206 and 207.' *Gulf States Utilities Company v. FPC*, 411 U.S. 747, 758-59 (1972)." *Id.* at p. 61,490 (footnote omitted). The Commission reaffirmed that it would examine how best to fulfill this responsibility, as well as its responsibility to prevent undue discrimination, in light of the changing conditions in the electric utility industry. *Id.*

conditions faced by similarly situated third-party customers) to include a focus on the rates, terms, and conditions of a utility's own uses of the transmission system:

[A]n open access tariff that is not unduly discriminatory or anticompetitive should offer third parties access on the same or comparable basis, and under the same or comparable terms and conditions, as the transmission provider's uses of its system.[72]

Refocusing the analysis was necessitated by the changing conditions in the electric utility industry, including the emergence of non-traditional suppliers and greater competition in bulk power markets. Because a transmission provider may use its system in different ways (*e.g.*, to integrate load and resources when serving retail native load, to make off-system sales or purchases, or to serve wholesale requirements customers), the Commission set for hearing the factual issues associated with identifying those uses, as well as any potential impediments or consequences to providing comparable services to third parties.[73]

After *AEP*, the Commission applied this comparability standard to a proposed open access transmission tariff that was filed by Kansas City Power & Light Company (KCP&L) in support of a proposal to sell generation at market-based rates.[74] The Commission explained that, in light of *AEP*, the utility's proposed open access transmission tariff (which provided only

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for point-to-point service) did not adequately mitigate its transmission market power so as to justify allowing the

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72 *Id.* at p. 61,490.

73 *Id.* at pp. 61,490-91.

74 *See Kansas City Power & Light Company*, 67 FERC ¶61,183 (1994), *reh'g pending*.

requested market-based rates. KCP&L could charge market-based rates for sales only if it modified its proposed transmission tariff to reflect the *AEP* comparability standard.

Since then, the Commission has required comparable service in a variety of contexts, and has set for hearing the factual issues associated with comparable service. For example, the Commission found that market power can be adequately mitigated only if a merged company offers transmission services in accordance with the *AEP* comparability standard.[75] The Commission further held that, even if a merger does not result in an increase in market power, the merger would not be consistent with the public interest under section 203 of the FPA unless the merged company offers comparable transmission services, as defined in *AEP*.[76] The Commission therefore announced a transmission comparability requirement for all new mergers:

Given the transition of the electric utility industry as a whole, we conclude that, absent other compelling public interest considerations, coordination in the public interest can best be secured only if merging utilities offer comparable transmission services.[77]

In *Heartland Energy Services, Inc.*,[78] the Commission applied its comparability standard to an affiliated electric power marketer seeking blanket authorization to sell electricity at market-based rates. The Commission explained that

> For all future cases involving blanket approval of market-based rates an offer of comparable transmission services will be required before the

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75 *E.g., CSW, supra*, 68 FERC at p. 61,914.

76 *Id.*

77 *Id.* at p. 61,915 (footnote omitted).

78 *68 FERC* ¶61,223 (1994).

> Commission will be able to find that transmission market power has been adequately mitigated. In the context of an affiliated power marketer, this means that all of its affiliated utilities must have a comparable transmission tariff on file.[79]

The Commission also denied a request by a company affiliated with a transmission-owning utility seeking permission to sell power at market-based rates to a particular customer. The denial was without prejudice to refiling such a request in a new section 205 proceeding, but only after the affiliated transmission-owning utility filed a comparable transmission service tariff.[80] The Commission added that it

> will require comparability in any situation in which a seller seeking market-based rates is affiliated with an owner or controller of transmission facilities.[81]

The Commission has also stated that "it will henceforth apply the transmission comparability standard announced in the *AEP* case to all transmitting utility members of an RTG."[82]

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79 *Id.* at p. 62,060. *In InterCoast Power Marketing Company*, 68 FERC ¶61,248, *clarified*, 68 FERC ¶61,324 (1994), the Commission rejected an affiliated marketer's proposal to sell at market rates without its affiliate utility offering comparable transmission services. The Commission stated that the only way to ensure that InterCoast does not have transmission market power is to require its affiliated public utility to offer comparable transmission services. *See also LG&E Power Marketing Inc.*, 68 FERC ¶61,247, at pp. 62,120-21 (1994). The Commission added that this is consistent with encouraging competitive bulk power markets as envisioned by the Energy Policy Act of 1992. *Id.* at p. 62,132.

80 *See Hermiston Generating Company*, 69 FERC ¶61,035, at p. 61,164 (1994), *reh'g pending*. The Commission subsequently accepted the rates on a cost basis. See Letter Order dated November 10, 1994.

81 *Id.* at p. 61,165.

82 *See SWRTA*, 69 FERC at p. 61,397; *see also PacifiCorp, the California Municipal Utilities Association, and the Independent Energy*

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The Commission further declared that comparable services must be provided through "open access" tariffs rather than only on a contract-by-contract basis:

[T]ariffs are essential to the provision of comparable services. Tariffs set out the services that are available and the terms and conditions under which those services will be made available * * *. [In contrast], a negotiation process creates uncertainty and imposes on customers delay and other transaction costs that the transmitting utility members of an RTG do not incur when using the transmission for their own benefit. Moreover, the ability to execute separate transmission agreements with different but similarly situated customers is the ability to unduly discriminate among them. A tariff ensures against such discrimination in the RTG.[83]

Thus, the Commission required the RTGs to amend their bylaws to commit all transmitting utility members to offer comparable transmission services to other RTG members pursuant to a transmission tariff or tariffs.

As discussed below, since the *AEP* comparability standard was announced, the Commission has set for hearing 44 open access tariffs to determine what constitutes comparable service. This number includes tariffs filed subsequent to the Open Access NOPR. All tariffs have now been made subject to the outcome of the Final Rule.

Producers (on behalf of Western Regional Transmission Association), 69 FERC ¶61,099, *order on reh'g*, 69 FERC ¶61,352 (1994), *order on compliance filing*, 71 FERC ¶61,158 (1995) (*WRTA*). An RTG is a regional transmission group. It is defined as "a voluntary organization of transmission owners, transmission users, and other entities interested in coordinating transmission planning (and expansion), operation and use on a regional (and inter-regional." Policy Statement Regarding Regional Transmission Groups, 58 FR 41626 (August 5, 1993), *FERC Statutes and Regulations* ¶30,976, at p. 30,870 n.4 (RTG Policy Statement).

83 *SWRTA*, 69 FERC at p. 61,398.

3. Lack of Market Power in New Generation

In 1994 in the *KCP&L* case, discussed in the prior section, the Commission continued to recognize that transmission remains a natural monopoly. However, it found that, in light of the industry and statutory changes that now allow ease of market entry, no wholesale seller of generation has market power in generation from *new* facilities.[84] In particular, the Commission explained that it had previously noted in *Entergy Services, Inc.* that

There was significant evidence that non-traditional power project developers, including qualifying facilities and independent power projects, are becoming viable competitors in long-run markets.[85]

The Commission further explained that since *Entergy*, Congress had enacted the Energy Policy Act, which had lowered barriers to the entry of new suppliers by creating a new class of power suppliers--EWGs--that are exempt from the provisions of PUHCA.[86] The Commission concluded that, in considering market-based rate proposals for generation sales, it need only focus on market power in transmission, generation market power in short-run markets, and other barriers to entry.[87]

4. Further Commission Action Addressing a More Competitive Electric Industry

To address the fact that the electric industry is becoming more competitive, and to remove barriers that might inhibit a

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84 *KCP&L*, 67 FERC ¶61,183 (1994).

85 *Id.* at p. 61,557 (*citing Entergy Services, Inc.*, 58 FERC ¶61,234, at p. 61,756 and nn.63 and 65 (*Entergy*)).

86 *Id.* The Commission added that "after examining generation dominance in many different cases over the years, we have yet to find an instance of generation dominance in long-run bulk power markets." *Id.*

87 *Id.*

more competitive industry, the Commission has initiated a number of proceedings: (1) Stranded Cost NOPR,[88] (2) Transmission Pricing Policy Statement,[89] (3) Pooling Notice of Inquiry,[90] (4) Regional Transmission Group (RTG) Policy Statement,[91] and (5) Notice of Inquiry on Merger Policy.[92]

In the Stranded Cost NOPR the Commission recognized that the trend toward greater transmission access and the transition

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to a fully competitive bulk power market could cause some utilities to incur stranded costs as wholesale requirements customers (or retail customers) use their supplier's transmission to purchase power elsewhere. As the Commission noted, a utility may have built facilities or entered into long-term fuel or purchased power supply contracts with the reasonable expectation that its customers would renew their contracts and would pay their share of long-term investments and other incurred costs. If the customer obtains another power supplier, the utility may have stranded costs. If the utility cannot locate an alternative buyer or somehow mitigate the stranded costs, the Commission explained that "the costs must be recovered from either the departing customer or the remaining

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88 *FERC Statutes and Regulations* ¶32,507 (1994).

89 Inquiry Concerning the Commission's Pricing Policy for Transmission Services Provided by Public Utilities Under the Federal Power Act, 59 FR 55031 (November 3, 1994), *FERC Statutes and Regulations* ¶31,005 (Transmission Pricing Policy Statement).

90 Inquiry Concerning Alternative Power Pooling Institutions Under the Federal Power Act, 59 FR 54851 (October 26, 1994), *FERC Statutes and Regulations* ¶35,529 (1995) (Pooling Notice of Inquiry).

91 *FERC Statutes and Regulations* ¶30,976 (RTG Policy Statement).

92 *FERC Statutes and Regulations* ¶35,531 (1996).

customers or borne by the utility's shareholders."[93] Accordingly, the Commission proposed to establish provisions concerning the recovery of wholesale and retail stranded costs by public utilities and transmitting utilities.

In the Transmission Pricing Policy Statement, the Commission announced a new policy providing greater flexibility in the pricing of transmission services provided by public utilities and transmitting utilities. The Commission traditionally had allowed only postage-stamp, contract-path pricing.[94] Under the new policy, we will permit a variety of proposals, including distance sensitive and flow-based pricing, which may be more suitable for competitive wholesale power markets.[95] The Commission explained that this "[g]reater pricing flexibility is appropriate in light of the significant competitive changes occurring in wholesale generation markets, and in light of our expanded wheeling authority under the Energy Policy Act of 1992."[96] However, the Commission explained that any new transmission pricing

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93 *FERC Statutes and Regulations* ¶32,507, at p. 32,864.

94 Most transmission contracts set a single price for energy flow over a utility's transmission system. This single-price policy is called "postage stamp" pricing because the rate does not depend on how far the power moves within a company's transmission system. If power flows through several companies, traditional industry practice is to specify that power flows along a "contract path" consisting of the transmission-owning utilities between the ultimate receipt and delivery points. *See Indiana Michigan Power Company*, 64 FERC ¶61,184, at p. 62,545 (1993).

95 Unlike with postage stamp pricing, with distance-sensitive pricing the cost of moving power through a company depends on how far the power moves within the company. In contrast to contract path pricing, flow-based pricing establishes a price based on the costs of the various parallel paths actually used when the power flows. Because flow-based pricing can account for all parallel paths used by the transaction, all transmission owners with facilities on any of the parallel paths could be compensated for the transaction.

96 *FERC Statutes and Regulations* ¶31,005, at p. 31,136.

proposal must meet the Commission's *AEP* comparability standard. The Commission further explained that comparability of service applies to price as well as to terms and conditions.[97]

The Commission issued the Pooling Notice of Inquiry to receive comments on traditional power pools and on alternative power pooling institutions that are being explored in today's more competitive environment. The Commission expressed concern that

[G]iven the ongoing changes in the competitive environment of the electric utility industry--in particular, the potential for substantially increased access to transmission--we must consider whether we are appropriately balancing our dual objectives of promoting coordination and competition.[98]

Accordingly, the Commission explained that it wished to look at alternative power pooling institutions and to re-examine the role of more traditional power pools in today's environment of increased competition. In particular the Commission expressed its intent to ensure that its policies "are consistent with the development of a competitive bulk power market."[99]

In the RTG Policy Statement, the Commission announced a policy encouraging the development of RTGs. The Commission explained that a primary purpose of RTGs is to facilitate transmission access for potential users and voluntarily resolve

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97 *Id.* at p. 31,142.

98 *FERC Statutes and Regulations* ¶35,529, at p. 35,715.

99 *Id.* at p. 35,714. As explained below, the Commission held technical conferences on issues surrounding power pools and competition.

disputes over such service. The Commission has approved the formation of three RTGs.[100] One of the conditions is that each RTG member must offer comparable transmission services by tariff to other RTG members.

In the merger NOI, the Commission indicated that it will review whether its criteria and policy for evaluating mergers need to be modified in light of the changing circumstances occurring in the electric industry.

In addition to the Commission's actions, a number of states have initiated proceedings concerning retail wheeling or proposed legislation for retail wheeling, that is, for ultimate consumers to choose their supplier of power, or other restructuring proposals.[101]

5. Events Since Issuance of Open Access NOPR

Since issuance of the Open Access NOPR, public utilities have filed, in some form or another, 47 open access tariffs. In acting on those filings, the Commission has made

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[100] *See WRTA* and *SWRTA, supra, and Northwest Regional Transmission Association*, 71 FERC ¶61,397 (1995).

[101] At least 12 states have retail wheeling proposals, legislation, or pilot programs underway-- Alabama, California, Connecticut, Illinois, Massachusetts, Michigan, New Hampshire, New York, Ohio, Rhode Island, Vermont, and Wisconsin. At least 14 other states are investigating retail wheeling. Currently, according "to a report of the NARUC-affiliated National Council on competition and the Electric Industry, 41 States are actively involved in investigating whether and how to restructure their respective electric power markets. Of this total, 29 State regulatory authorities * * * have initiated investigations. In addition, five State legislatures are involved in similar investigations, while seven other States have joint regulatory/legislative proceedings underway."

Testimony of the Honorable Cheryl L. Parrino, Chair of the Wisconsin Public Service Commission, on behalf of the National Association of Regulatory Utility Commissioners, before the United States Senate Committee on Energy and Natural Resources (March 6, 1996).

all of the non-rate terms and conditions of those proposed tariffs subject to the outcome of this Final Rule.[102]

Over the last year, the Commission also has received and analyzed more than 20,000 pages of comments that were received from over 400 commenters, as well as additional information provided by industry participants at a number of Commission-initiated technical conferences.[103] Those technical conferences addressed several issues--ancillary services, pro forma tariffs, power pools, and ISOs--and provided significant input to the Commission's formulation of this Final Rule.

F. Need for Reform

The many changes discussed above have converged to create a situation in which new generating capacity can be built and operated at prices substantially lower than many utilities' embedded costs of generation. As discussed above, new generation facilities can produce power on the grid at a cost of less than 3 cents per kWh to 5 cents per kWh, yet the costs for large plants constructed and installed over the last decade were typically in the range of 4 to 7 cents per kWh for coal plants and 9 to 15 cents for nuclear plants.

Non-traditional generators are taking advantage of this opportunity to compete. Indeed, the non-traditional generators' share of total U.S. electricity generation increased from 4 percent in 1985 to 10 percent in 1993.[104] Much of this increased share of generation is the result of competitive bidding for new generation resources that has

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[102] *See American Electric Power Service Corporation*, et al., 72 FERC ¶61,287, at p. 61,238 (1995).

[103] Attached to this Final Rule as Appendix B is a list of commenters and the abbreviations used to designate them, including those commenters that filed late.

[104] Energy Information Administration, *Performance Issues for a Changing Electric Power Industry* (January 1995) 10 and (Figure 5).

occurred in 37 states. Since 1984, almost 4,000 projects, representing over 400,000 MW, have been offered in response to requests. Over 350 projects have been selected to supply 20,000 MW, and, of these, 126 are now online producing almost 7,800 MW of power. [105]

In addition, the cost of utility-generated electricity differs widely across the major regions of the United States. Average utility rates range from 3 to 5 cents in the Northwest to 9 to 11 cents in Califor-

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nia. Electricity consumers are demanding access to lower cost supplies available in other regions of the United States, and access to the newer, lower cost generation resources. Therefore, it is important that the non-traditional generators of cheaper power be able to gain access to the transmission grid on a non-discriminatory open access basis.

The Commission's goal is to ensure that customers have the benefits of competitively priced generation. However, we must do so without abandoning our traditional obligation to ensure that utilities have a fair opportunity to recover prudently incurred costs and that they maintain power supply reliability. As well, the benefits of competition should not come at the expense of other customers. The Commission believes that requiring utilities to provide non-discriminatory open access transmission tariffs, while simultaneously resolving the extremely difficult issue of recovery of transition costs (discussed *infra*), is the key to reconciling these competing demands.

Non-discriminatory open access to transmission services is critical to the full development of competitive wholesale generation markets and the lower consumer prices achievable

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105 Current Competition, November 1994, Vol. 5, No. 8, at p. 8.

through such competition.[106] Transmitting utilities own the transportation system over which bulk power competition occurs and transmission service continues to be a natural monopoly. Denials of access (whether they are blatant or subtle), and the potential for future denials of access, require the Commission to revisit and reform its regulation of transmission in interstate commerce. As discussed in detail in Section IV.B., such action is required by the FPA's mandate that the Commission remedy undue discrimination.

Since the time the NOPR issued, the Commission staff has completed an FEIS that provides a quantitative estimate of some of the cost savings expected from this Rule: approximately $3.8 to $5.4 billion per year. Other non-quantifiable benefits are also expected from this Rule and include: (1) better use of existing assets and institutions; (2) new market mechanisms; (3) technical innovation; and (4) less rate distortion. These potential benefits to the Nation's electricity consumers and the economy as a whole confirm the need to take generic action to remove barriers to competition. In what follows, we set out the changes necessary to remedy undue discrimination and to ensure a fair transition to a more competitive regulatory regime.

IV. Discussion

A. Scope of the Rule

1. Introduction

The Commission has determined that non-discriminatory open access transmission services (including access to transmission information) and stranded cost recovery are the most critical components of a successful transition to competitive wholesale electricity markets. These issues are

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[106] As discussed above, a significant number of public utilities still do not have any form of an "open access" tariff on file with the Commission and no public utility has on file a non-discriminatory open-access tariff as defined by this Rule.

the focal point of this Rule, the accompanying rule on open access same-time information systems, and the accompanying proposed rule on capacity reservation tariffs.

In undertaking these initiatives, however, we are mindful that they are part of a broader picture of evolving issues affecting the electric industry and that other Commission policies will play an important role in ensuring the full development of competitive markets. Among the many issues that are important to competitive bulk power markets are: independent system operators (ISOs); regional transmission groups; generation market power; utility merger policy; and the development of innovative transmission pricing alternatives, such as flow-based, distance-sensitive transmission pricing methodologies that reflect incremental costs. In particular, we believe that ISOs have great potential to assist us and the industry to help provide regional efficiencies, to facilitate economically efficient pricing, and, especially in the context of power pools, to remedy undue discrimination and mitigate market power. Although we discuss some of these issues in this Rule, we will further develop our policies in other proceedings as well to accommodate and encourage more efficient market structures.

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We now address the comments received on the scope of the proposed rulemaking.

2. Functional Unbundling

In the NOPR, the Commission preliminarily found that functional unbundling of wholesale generation and transmission services is necessary to implement non-discriminatory open access transmission.[107] At the same time, the Commission explained that the proposed rule would

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107 *FERC Statutes and Regulations* ¶32,514, at p. 33,080.

accommodate, but not require, corporate unbundling (which could include selling generation or transmission assets to a non-affiliate (divestiture) or the less aggressive step of establishing separate corporate affiliates to manage a utility's transmission and generation assets). However, we invited comments on functional unbundling and asked whether it is a strong enough measure to ensure non-discriminatory open access transmission without some form of corporate restructuring.

Comments

Commenters take both sides on whether functional unbundling is sufficient to assure non-discriminatory open access transmission or whether a stronger measure, such as corporate unbundling, is needed.

Supporting Functional Unbundling

Various commenters, including utilities and state commissions, generally support functional unbundling as sufficient to assure non-discriminatory open access transmission and oppose requiring corporate unbundling or divestiture.[108] Several commenters state that functional unbundling will remedy discrimination without creating the inefficiencies and additional costs that corporate restructuring would create.[109]

A number of other commenters argue that the Commission has no authority under the FPA to require

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[108] *E.g.*, Ohio Edison, UtiliCorp, Pennsylvania P&L, Atlantic City, Montana Power, IL Com, Seattle, OK Com, TX Industrials, MidAmerican, Southwestern, Southern, DOD, Public Service Co of CO, SC Public Service Authority, Florida Power Corp, DOE, WP&L, Com Ed, SBA, Consumers Power, CA Com, UT Com, Houston L&P, KCPL, EEI.

[109] *E.g.*, Florida Power Corp, El Paso, PSNM, and SC Public Service Authority.

divestiture of transmission assets.[110] Several of these commenters assert that, even if the Commission has the authority, the electric industry, unlike the natural gas industry, is not ready for mandated corporate unbundling because electric utilities still serve a high percentage of retail customers and own large amounts of the generating capacity. They assert that transmission system operation requires the operator to have control over much of the generating capacity.

Various other commenters also support functional unbundling, but believe that safeguards are needed to make it work[111] Power Marketing Association, for example, suggests a number of safeguards: adoption of cost allocation mechanisms to ensure that utilities do not shift costs from generation to transmission; random audits of utility books; a requirement that each utility file a code of conduct that provides for maximum separation of generation and transmission functions; and active oversight and complaint procedures with strong penalties for abuse. OK Com and GA Com believe that functional unbundling along with the safeguard of the Commission's complaint process will provide sufficient incentive for non-discriminatory open access transmission.

Supporting Corporate Unbundling

A number of commenters see weaknesses in functional unbundling and argue that some form of corporate unbundling is necessary to assure non-discriminatory open

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110 *E.g.*, Southwestern, PECO, El Paso, Florida Power Corp, NSP, Public Service E&G, MidAmerican.

111 *E.g.*, NRECA, IN Com, Power Marketing Association, TDU Systems, NorAm, Turlock, Texaco, Utility Shareholders, NSP, El Paso, Utility Investors Analysts, PECO, Florida Power Corp, UT Com, Sierra, Carolina P&L, SoCal Gas, OK Com, FL Com, Southern.

access transmission.[112] American Forest & Paper says that there is affiliate abuse in the gas industry and argues that

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the electric industry presents even more serious potential for abuse because it is still dominated by vertically integrated utilities.[113] UAMPS asserts that functional unbundling is insufficient because the utility will still favor itself on issues related to transmission planning, capital investment, and operation and maintenance and replacement costs.

NIEP argues that divestiture of generation assets from transmission and distribution is the preferred mechanism for mitigating market power. It further suggests that if corporate divestiture is not feasible the Commission should

> seek to achieve "virtual divestiture" by requiring that the utility generation function be separated from transmission and distribution functions in a separate corporate affiliate, or business unit, and that affiliate transaction rules be established to guard against possible abuses.[114]

It maintains that the Commission has broad authority to protect against undue discrimination and anticompetitive behavior and can order divestiture if such action is required to remedy such behavior.[115]

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[112] *E.g.*, American Forest & Power, American National Power, ND Com, IL Com, UAMPS, NIEP, APPA, Public Poweer Council, Municipal Energy Agency Nebraska, Missoui Basin MPA, Texaco, Direct Service Industries, Calpine, CCEM, Wisconsin Coalition, VT DPS.

[113] *See also* American National Power, ND Com, Calpine.

[114] NIEP Initial Comments at p. 4.

[115] *See also* Municipal Energy Agency Nebraska, Direct Services Industries.

FTC and DOJ argue that operational unbundling, an example of which is the formation of an independent system operator (ISO), likely would be more effective than functional unbundling and less costly than industry-wide divestiture.[116] FTC describes operational unbundling as "structural institutional arrangements, short of divestiture, that would separate operation of the transmission grid and access to it from economic interests in generation." It gives as an example the California proposal under which utilities would continue to own transmission lines, but an independent system operator would have operational control. DOJ also suggests "a separate authority" to manage the grid and access to the grid, joint ventures, and voluntary pooling arrangements. These commenters argue that operational unbundling would be easier to enforce than functional unbundling.

DOE states that separation of the control of transmission from vertically-integrated companies does not necessarily require a poolco or any particular market mechanism. It suggests the possibility of an ISO that is functionally separate from any buyer or seller of generation, but would not perform all the functions of a poolco.

United Illuminating supports "operational unbundling" that would either (1) eliminate vertical integration and divestiture of transmission assets, leading to the formation of a regional transmission company, or (2) develop a regional contractual approach to transmission services that eliminates the transmission owner's market power and fairly allocates support of the transmission facilities between native load and third-party users of the system.

Commission Conclusion

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116 Others oppose operational unbundling. *See, e.g.*, Carolina P&L, Salt River.

We conclude that functional unbundling of wholesale services is necessary to implement non-discriminatory open access transmission and that corporate unbundling should not now be required. As we explained in the NOPR, functional unbundling means three things:

(1) a public utility must take transmission services (including ancillary services) for all of its new wholesale sales and purchases of energy under the same tariff of general applicability as do others;

(2) a public utility must state separate rates for wholesale generation, transmission, and ancillary services;

(3) a public utility must rely on the same electronic information network that its transmission customers rely on to obtain information about its transmission system when buying or selling power.

We believe that these requirements are necessary to ensure that public utilities provide non-discriminatory service.[117] These requirements also will give public

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utilities an incentive to file fair and efficient rates, terms, and conditions, since they will be subject to those same rates, terms, and conditions.

However, we recognize that additional safeguards are necessary to protect against market power abuses. Functional unbundling will work only if a strong code of conduct (including a requirement to separate employees involved in transmission functions from those involved in wholesale power merchant functions) is in place. In the RINs NOPR,

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[117] When and how functional unbundling is to be achieved for requirements transactions and for various types of coordination arrangements, including power pools, is discussed at Sections IV.A.5 and IV.F. Functional unbundling of ancillary services is discussed in Section IV.D.

the Commission proposed a code of conduct that would apply to all public utility transmission providers. As the Commission explained,

> [t]his code of conduct would require, among other matters, a separation of the utilities' transmission system operations and wholesale marketing functions, and would define permissible and impermissible contacts between employees that conduct wholesale generation marketing functions and employees that handle transmission system operations and reliability in the system control center or at other facilities or locations. [118]

Adoption of this code of conduct, discussed in detail in the accompanying final rule on OASIS,[119] is needed to ensure that the transmission owner's wholesale marketing personnel and the transmission customer's marketing personnel have comparable access to information about the transmission system.

As noted by OK Com and GA Com, a further safeguard--section 206--is available if a public utility seeks to circumvent the functional unbundling requirements. Under section 206, any person is free to file a complaint with the Commission detailing any alleged misbehavior on the part of the public utility or its affiliates concerning matters subject to our jurisdiction under the FPA. Similarly, the Commission may, on its own motion, initiate a proceeding to investigate the practices of the public utility and its affiliates.

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[118] Real-Time Information Networks and Standards of Conduct, Notice of Proposed Rulemaking, 60 FR 66182 (December 21, 1995), *FERC Statutes and Regulations* ¶32,516, at p. 33,170 (1995).

[119] The final rule on information systems no longer uses the terminology RINs. The new terminology used is OASIS--Open Access Same-time Information System--which we will use in this Final Rule.

We believe that functional unbundling, coupled with these safeguards, is a reasonable and workable means of assuring that non-discriminatory open access transmission occurs. In the absence of evidence that functional unbundling will not work, we are not prepared to adopt a more intrusive and potentially more costly mechanism--corporate unbundling--at this time.

Several commenters discuss the need to encourage or even to require ISOs in the context of functional unbundling. We believe that ISOs have the potential to provide significant benefits (*e.g.*, to help provide regional efficiencies, to facilitate economically efficient pricing, and, especially in the context of power pools, to remedy undue discrimination and mitigate market power) and will further our goal of achieving a workably competitive market. As we learned at our technical conference on power pools, many utilities are examining ISOs and corporate unbundling in various shapes and forms, particularly in the context of power pools. We discuss ISOs extensively in our section on power pools where we believe they will have an important role to play. However, in the context of individual utility transactions, we believe that the less intrusive functional unbundling approach outlined above is all that we must require at this time. Nevertheless, we see many benefits in ISOs, and encourage utilities to consider ISOs as a tool to meet the demands of the competitive marketplace.

As a further precaution against discriminatory behavior, we will continue to monitor electricity markets to ensure that functional unbundling adequately protects transmission customers. At the same time, we will analyze all alternative proposals, including formation of ISOs, and, if it becomes apparent that functional unbundling is inadequate or unworkable in assuring non-discriminatory open access transmission, we will reevaluate our position and decide whether other mechanisms, such as ISOs, should be required.

Finally, while we are not now requiring any form of corporate unbundling, we again encourage utilities to explore whether corporate unbundling or other restructuring

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mechanisms may be appropriate in particular circumstances. Thus, we intend to accommodate other mechanisms that public utilities may submit, including voluntary corporate restructurings (*e.g.*, ISOs, separate corporate divisions, divestiture, poolcos), to ensure that open access transmission occurs on a non-discriminatory basis. We also will continue to monitor--and stand ready to work with parties engaging in--innovative restructuring proposals occurring around the country.

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B. Legal Authority

The Commission reaffirms its conclusion in the NOPR that we have the authority under the FPA to order wholesale transmission services in interstate commerce to remedy undue discrimination by public utilities. We analyze below the relevant cases examining our wheeling authority,

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then discuss and respond to the legal arguments raised by the commenters.

1. Bases for Legal Authority

a. Undue Discrimination/Anticompetitive Effects

In upholding the Commission's order requiring non-discriminatory open access in the natural gas industry, the court in *Associated Gas Distributors v. FERC* stated that the Natural Gas Act "fairly bristles" with concern for undue

discrimination.[193] The same is true of the FPA. The Commission has a mandate under sections 205 and 206 of the FPA to ensure that, with respect to any transmission in interstate commerce or any sale of electric energy for resale in interstate commerce by a public utility, no person is subject to any undue prejudice or disadvantage. We must determine whether any rule, regulation, practice or contract affecting rates for such transmission or sale for resale is unduly discriminatory or preferential, and must prevent those contracts and practices that do not meet this standard. As discussed below, *AGD* demonstrates that our remedial power is very broad and includes the ability to order industry-wide non-discriminatory open access[194] as a remedy for undue discrimination. The *AGD* court reached this decision even in the face of prior cases that acknowledged that Congress did not mandate common carriage or explicitly empower the Commission to order direct access for either gas transporters or electric utilities. Moreover, the Commission's power under the FPA "clearly carries with it the responsibility to consider, in appropriate circumstances, the anticompetitive effects of regulated aspects of interstate utility operations pursuant to [FPA] §§ 202 and 203, and under like directives contained in §§ 205, 206, and 207."[195]

Therefore, based on the mandates of sections 205 and 206 of the FPA and the case law interpreting the Commission's authority over transmission in interstate commerce, we conclude that we have ample legal authority—indeed, a responsibility—under section 206 of the

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193 *Associated Gas Distributors v. FERC*, 824 F.2d 981, 998 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988) (*AGD*).

194 We use the term "open access" to refer to a public utility's obligation to put a tariff on file offering service to eligible customers. Access is not open to all. Specifically, the tariff is not an offer to serve retail customers if state law does not permit retail wheeling.

195 *Gulf States Utilities Company v. FPC*, 411 U.S. 747, 758-59 (1973).

FPA to order the filing of non-discriminatory open access transmission tariffs if we find such order necessary as a remedy for undue discrimination or anticompetitive effects.[196] We discuss below the primary court decisions that touch on our wheeling authority under sections 205 and 206.

The Commission's authority to order access as a remedy for undue discrimination under the Natural Gas Act (NGA) was upheld and discussed in detail in *AGD*. In *AGD*, the court upheld in relevant part the Commission's Order No. 436.[197] That order found the prevailing natural gas company practices to be "unduly discriminatory" within the meaning of section 5 of the NGA (the parallel to section 206 of the FPA) and held that if pipelines wanted blanket certification for their transportation services, they must commit to transport gas for others on a non-discriminatory basis; in other words, they must provide non-discriminatory open access.

In upholding the Commission's authority to require open access, the court first noted that the opponents' arguments against such authority must proceed "uphill." The statute contains no language forbidding the Commission to impose common carrier status on pipelines, let alone forbidding the Commission to impose "a specific duty that happens to be a typical or even core component of such status." The court found that the legislative

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196 In most situations, discrimination that precludes transmission access or gives inferior access will have at least potential anticompetitive effects because it limits access to generation markets and thereby limits competition in generation. Similarly, it is probable that any transmission provision that has anticompetitive effects would also be found to be unduly discriminatory or preferential because the anticompetitive provision would most likely favor the transmission owner *vis-a-vis* others.

197 Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, *FERC Statutes and Regulations, Regulations Preambles 1982-1985* ¶30,665 (1985).

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history cited by the opponents came nowhere near overcoming this statutory silence. Rather, the legislative history supported only the proposition that Congress itself declined to impose common carrier status.[198] Emphasizing Congress' deep concern with undue discrimination, the court found that the Commission had ample authority to "stamp out" such discrimination:

> The issue seems to come down to this: Although Congress explicitly gave the Commission the power and the duty to achieve one of the prime goals of common carriage regulation (the eradication of undue discrimination), the Commission's attempted exercise of that power is invalid because Congress in 1906 and 1914 and 1935 and 1938 itself refrained from affixing common carrier status directly onto the pipelines and from authorizing the Commission to do so. And this proposition is said to control no matter how sound the Order may be as a response to the facts before the Commission. We think this turns statutory construction upside down, letting the failure to grant a general power prevail over the affirmative grant of a specific one.[199]

The *AGD* court found that court decisions under the FPA did not support the view that the Commission's authority to "stamp out" undue discrimination is hamstrung by an inability to require non-discriminatory open access as a remedy. These decisions are discussed below.

One of the earliest cases on wheeling is *Otter Tail Power Company v. United States* (*Otter Tail*).[200] In that case, the Supreme Court rejected the argument that the District Court, in a civil antitrust suit, could not order wheeling because to

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198 *AGD, supra*, 824 F.2d at p. 997.

199 *Id.* at p. 998.

200 410 U.S. 366 (1974).

do so would conflict with the FPC's purported wheeling authority.[201] The Court explained that Congress had decided not to impose a common carrier obligation on the electric power industry and noted that the Commission was not at that time expressly granted power to order wheeling.[202] In effect, it concluded that because Congress did not include common carrier provisions in the FPA, the Commission must not have any express authority to order wheeling that would preclude the District Court from imposing a wheeling remedy. Nowhere, however, did the Court say that the Commission lacked authority under section 206 to remedy undue discrimination. Indeed, that was simply not a matter before the Court or of any consequence to its decision.

In the FPA, while Congress elected not to impose common carrier status on the electric power industry, it tempered that determination by explicitly providing the Commission with the authority to eradicate undue discrimination—one of the goals of common carriage regulation.[203] By providing this broad authority to the Commission, it assured itself that in preserving "the voluntary action of the utilities" it was not allowing this voluntary action to be unfettered. It would be far-reaching indeed to conclude that *Otter Tail*, which was a civil antitrust suit that raised issues entirely unrelated to our authority under section 206, is an impediment to our achieving one of the primary goals of the FPA—eradicating undue discrimination in transmission in interstate commerce in the electric power industry.

In *Richmond Power & Light Company v. FERC* (*Richmond*),[204] the FPC, in reaction to the 1973 oil embargo,

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201 410 U.S. at pp. 375-76.

202 *Id.* at pp. 374-76.

203 *See AGD*, 824 F.2d at p. 998.

204 574 F.2d 610 (D.C. Cir. 1978).

was attempting to reduce dependence on oil. The FPC requested that utilities with excess capacity wheel power to the New England Power Pool (NEPOOL). In response, several suppliers and transmission owners filed rate schedules with the FPC that provided for voluntary wheeling. Richmond Power & Light Company (Richmond) objected to these filings, claiming that they were unreasonable because they did not guarantee transmission access. The FPC refused to compel the utilities to wheel Richmond's power, stating that it did not have the authority to order a public utility to act as a common carrier.

The D.C. Circuit upheld the Commission. It acknowledged that Richmond's argument was persuasive in some respects,

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but stated that any conditions the Commission might impose could not contravene the FPA. The court examined the legislative history of the FPA and stated that "[i]f Congress had intended that utilities could inadvertently bootstrap themselves into common-carrier status by filing rates for voluntary service, it would not have bothered to reject mandatory wheeling * * *." [205]

However, the D.C. Circuit in no way indicated that the Commission was foreclosed from ordering transmission as a remedy for undue discrimination. Richmond also had argued that the alleged refusal of the American Electric Power Company (AEP) and its affiliate, Indiana & Michigan Electric Company (Indiana), to wheel Richmond's excess energy was unlawful discrimination because AEP and Indiana wheeled higher-priced electricity from other AEP affiliates. The court acknowledged that Richmond's claim of unlawful discrimination was theoretically valid, but found that Richmond had failed to prove its case. It noted that if

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[205] *Id.* at p. 620.

Richmond had argued that the rates were unjustifiably discriminatory, or that Indiana's failure to use its transmission capability fully or to purchase less expensive electricity for wheeling resulted in unnecessarily high rates, a different case would be before the court.[206] The case thus does not in any way limit the Commission's authority to remedy undue discrimination.

In Central Iowa Power Cooperative v. FERC, [207] the FPC[208] reviewed the terms of the Mid-Continent Area Power Pool (MAPP) Agreement under its section 205 and 206 authority. The agreement contained two membership limitations. First, the agreement established two classes of membership, with one class being entitled to more privileges than the other. Second, the agreement excluded non-generating distribution systems from pool services. The FPC found the first limitation on membership—the two-class system—to be unduly discriminatory and not reasonably related to MAPP's objectives. The FPC conditioned approval of the agreement under section 206 on the removal of the unduly discriminatory provision. The FPC found that the second limitation, the exclusion of non-generating distribution systems, was not anticompetitive and did not render the agreement inconsistent with the public interest.

On appeal, the D.C. Circuit affirmed the FPC's decision. The court found that the FPC did have authority to order changes in the scope of the MAPP agreement, *if* the agreement was unjust, unreasonable, unduly discriminatory

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206 *Id.* p. 623, nn.53 and 57.

207 606 F.2d 1156 (D.C. Cir. 1979).

208 While *Central Iowa* was pending, certain of the functions of the FPC were transferred to the FERC under the DOE Organization Act. Accordingly, the FERC was substituted for the FPC as the respondent in the case.

or preferential under section 206 of the FPA. The court stated:

The Commission had authority, * * * under section 206 of the Act, * * * to order changes in the limited scope of the Agreement, including the addition of pool services, if, in the absence of such modifications, the Agreement presented "any rule, regulation, practice or contract [that was] unjust, unreasonable, unduly discriminatory or preferential."[209] However, the court agreed with the FPC's conclusion that the limited scope of MAPP was not unjust, unreasonable, or unduly discriminatory. The court recognized that a pool was not invalid under section 206 merely because a more comprehensive arrangement was possible.

The D.C. Circuit upheld the Commission's refusal to eliminate the second limitation on membership by ordering MAPP participants to wheel to non-generating electric systems.[210] However, neither the Commission nor the court was presented with the argument that wheeling was necessary as a remedy for undue discrimination.

In Florida Power & Light Company v. FERC (Florida),[211] the Commission ordered Florida Power & Light Company (FP&L) to file a tariff setting forth FP&L's policy relating to the availability

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of transmission service.[212] FP&L objected to including such a policy statement in its tariff and argued that the filing of such

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209 606 F.2d at p. 1168.

210 *Id.* at p. 1169; *see also Municipalities of Groton v. FERC*, 587 F.2d 1296 (D.C. Cir. 1978).

211 660 F.2d 668 (5th Cir. 1981), *cert. denied sub nom. Fort Pierce Utilities Authority v. FERC*, 459 U.S. 1156 (1983).

212 FP&L provided transmission service when four conditions were met: (1) the specific potential seller and buyer were contractually

a policy would convert FP&L into a common carrier by obligating it to offer service to all customers.[213] There was no finding that the action ordered was necessary to remedy undue discrimination.

The Fifth Circuit Court of Appeals agreed with FP&L that the mandatory filing of the policy statement would require FP&L to provide transmission service beyond its voluntary commitment because such a requirement would change its duties and liabilities.[214] The Commission order would impose common carrier status on FP&L, the court found.[215] The court noted that the Commission did not rely on a finding of anticompetitive behavior and therefore the court did not address the Commission's power to remedy antitrust violations.[216]

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identified; (2) the magnitude, time and duration of the transaction were specified prior to the commencement of the transmission; (3) it could be determined that the transmission capacity would be available for the term of the contract; and (4) the rate was sufficient to cover FP&L's costs.

213 All utilities requesting wheeling services, subject to availability, would be entitled to receive transmission service under the filed terms. Any changes to a filed rate must be filed with the Commission. This is the so-called "filed rate doctrine." *See Northwestern Public Service Company v. Montana-Dakota Utilities Company*, 181 F.2d 19, 22 (8th Cir. 1980), aff'd, 341 U.S. 246 (1951).

214 Under the filed rate doctrine, a refusal to wheel would be unduly discriminatory under section 206 of the FPA. As the court acknowledged, a customer refused service could petition the Commission to find that FP&L's policy of availability was unduly discriminatory under section 206(a) of the FPA. The court said that in the absence of a tariff on file, a utility refused wheeling services would be unable to claim discrimination under section 206(a) of the FPA. 660 F.2d at p. 675 (expressing "serious doubts that such a petition would be successful in the absence of a tariff").

215 *Id.* at p. 676.

216 *Id.* at p. 678.

The *AGD* court explicitly rejected the claim that the above line of cases establishes that the Commission lacks authority to require non-discriminatory open access.[217] Opponents of the Commission's order argued in *AGD* that *Richmond* and *Florida, supra*, stand for the proposition that the Commission cannot indirectly do what it allegedly cannot do directly, that is, impose common carriage. The *AGD* court rejected these arguments, stating that the petitioners read the electric cases far too broadly:

> [n]either *Richmond* nor *Florida* comes anywhere near stating that the Commission is barred from imposing an open-access condition in all circumstances.[218]

The court noted that the *Florida* case had expressly left open the question of whether the Commission would be entitled to use an open access condition as a remedy for anticompetitive conduct, and that in *Richmond* the D.C. Circuit had said little more than that unwillingness to transmit for all could not be automatically deemed undue discrimination. The court also noted the *Central Iowa* case, *supra*, in which it had upheld a Commission order that found a power pooling agreement discriminatory on its face because the agreement gave one class of membership privileged status over another. The court stated that the *Central Iowa* case "upholds the power of the Commission to subject approval of a set of voluntary transactions to a condition that providers open up the class of permissible users."[219] The court added that it refused to "turn statutory construction upside down" by letting Congress'

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[217] The *AGD* court did not address *New York State Electric & Gas Corporation v. FERC*, 638 F.2d 388 (2d Cir. 1980), *cert. denied*, 454 U.S. 821 (1981) (*NYSEG*), presumably because that case did not concern whether the Commission could order wheeling as a remedy for undue discrimination.

[218] 824 F.2d at p. 999.

[219] 824 F.2d at p. 999.

failure to grant a general power of common carriage prevail over the affirmative grant of the specific power to eradicate undue discrimination.[220]

We conclude that *AGD*'s analysis of undue discrimination under sections 4 and 5 of the Natural Gas Act is equally applicable to an undue discrimination analysis under sections 205 and 206 of the

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FPA. The Commission and courts have long recognized that the NGA was patterned after the FPA and that the two statutes should be interpreted in the same manner.[221] Thus, we conclude that we have the authority to remedy undue discrimination and anticompetitive effects by requiring all public utilities that own, control or operate transmission facilities to file non-discriminatory open access transmission tariffs.

b Section 211 of the Federal Power Act

In concluding that we must invoke our section 206 authority to remedy undue discrimination and anticompetitive effects in the electric industry, we have carefully considered the goals of Title VII of the Energy Policy Act, and whether section 211 of the FPA, by itself, is sufficient to remedy undue discrimination in public utility transmission services. Title VII of the Energy Policy Act, which amended section 211 of the FPA to give the Commission broader authority to order wheeling in the public interest on a case-by-case basis, reflects the intent of

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220 *Id.* at p. 1006.

221 *See, e.g., FPC v. Sierra Pacific Power Company*, 350 U.S. 348, 353 (1956); *Arkansas Louisiana Gas Company v. Hall*, 453 U.S. 571, 577 n.7 (1981); and *Kentucky Utilities Company v. FERC*, 760 F.2d 1321, 1325 n.6 (D.C. Cir. 1985). Section 206 of the FPA was recently revised and now differs from section 5 of the NGA, but not in a manner significant to our discussion here. See 16 U.S.C. §§824e (b) and (c).

Congress to encourage competitive wholesale electric markets. Section 211 provides a means for wholesale power sellers and buyers to obtain transmission service necessary to compete in, or to reach, competitive markets, and is a valuable tool to encourage competitive markets. However, in amending section 211, Congress left unaltered the authorities and obligations of the Commission under sections 205 and 206 (similar to our authorities and obligations under sections 4 and 5 of the NGA) to remedy undue discrimination. In addition, as discussed below, reliance on section 211 alone in some circumstances can result in the perpetuation of, rather than the elimination of, undue discrimination and anticompetitive effects.

First, there are inherent delays in the procedures for obtaining service under section 211. However, for competitive reasons, many transactions must be negotiated relatively quickly. Many competitive opportunities will be lost by the time the Commission can issue a final order under section 211. Case-by-case section 211 proceedings are not a substitute for tariffs of general applicability that permit timely, non-discriminatory access on request.

Second, discrimination is inherent in the current industry environment in which some customers and sellers are served by open access systems, and others have to rely on negotiated bilateral arrangements or the mandatory section 211 process. The end result is discrimination in the ability to obtain transmission services, as well as in the quality and prices of the services. This national patchwork of open and closed transmission systems, with disparate terms and conditions of service, cannot be cured effectively through section 211.

The Commission believes that its actions under sections 205 and 206 will complement the section 211 procedures to achieve both the Energy Policy Act's goals of creating more competitive bulk power markets and lower rates for consumers and the Federal Power Act's explicit direction in section 205(b) that no public utility shall, with respect to any

transmission in interstate commerce, grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage.

2. Response to Commenters Opposing Our Legal Authority

a. Authority to Order Open Access Tariffs

Comments

Initial Comments Supporting Commission Authority

A number of commenters support or state that they do not oppose the Commission's authority to order open access tariffs.[222] NIEP and CCEM explain that the AGD decision supports the Commission's action in this proceeding. ELCON asserts that the Commission's "extensive treatment of the relevant case law demonstrating FERC's authority to remedy this discrimination is legally sound." UtiliCorp argues that section 211 supports, rather than undermines, the Commission's

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authority for the NOPR because it reflects Congress's intention to encourage more competitive bulk power markets.

Initial Comments Opposing Commission Authority

Other commenters assert that the Commission has improperly relied on sections 205 and 206 of the FPA to require open access.[223] They argue, for instance, that *Otter Tail* should be read as a broad constraint on the Commission's authority to order wheeling for any purpose and that the *AGD* decision does not undermine that holding

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[222] NIEP, ELCON, CINergy, UtiliCorp, TAPS, SBA, Entergy, NY Energy Buyers, Sierra.

[223] *E.g.*, EEI, Atlantic City, Allegheny, VA Com, PA Com, Ohio Edison, Southern, Utilities For Improved Transition, Dayton P&L, SCE&G, Centerior, BG&E, Central Hudson, NY Com, Salt River, Carolina P&L, Union Electric, VEPCO, Utility Workers Union.

or the cases following *Otter Tail.*[224] In support, some of these commenters discuss *Richmond Power & Light, New York State Electric & Gas Corporation*, and *Florida Power & Light Company*, the same cases discussed by the Commission in the NOPR.[225]

For example, EEI highlights the *AGD* court's discussion noting the difference between the legislative history of the NGA and that of the FPA, which the court stated was not as strong as that of the NGA. Moreover, EEI argues that the court found that section 7 of the NGA provided support for the Commission's actions in Order No. 436 and that such section 7 conditioning authority is lacking under the FPA. Allegheny notes that *AGD* did not overrule *Otter Tail.* Dayton P&L states that, in the gas case, the Commission was responding to voluntary filings by pipelines. It also says that before the NOPR, the Commission itself saw its authority as more limited. SCE&G points to differences between Commission jurisdiction over public utilities and gas pipelines and criticizes the Commission's alleged assumption that the circumstances involved in the gas and electric industries are virtually identical.

PA Com argues that the attempt to analogize to the NGA and the cases that refer to that Act is inconsistent with the technical and engineering realities of the electric transmission grid and that extensive comparisons between the natural gas industry and the electric industry are misleading.[226]

FL Com argues that, in relying on sections 205 and 206 to establish generic open access transmission tariffs for all

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[224] EEI, VA Com, Union Electric

[225] *E.g.*, EEI, VA Com, NY Com, PA Com, Salt River, Southern, Dayton P&L, Detroit Edison, BG&E.

[226] *See also* NY Com (NGA has no parallel provision to section 211 of the FPA), Salt River.

public utilities, the Commission violates the court's decision in *Cajun Electric Power Cooperative v. FERC* , 28 F.3d 173 at 179 (D.C. Cir. 1994), where, FL Com argues, the court refused to allow the Commission to use a non-evidentiary ruling when there were material facts at issue.

Reply Comments

CCEM responds that EEI and others confuse the obligations of a common carrier with the duty of public utilities not to unduly discriminate. It says that *AGD* supports the Commission's authority because the legislative history of the FPA and the NGA are similar with respect to common carriage. According to CCEM, early versions of both statutes would have made the regulated industries operate as common carriers (citing *Otter Tail*, the legislative history of the FPA, the legislative history of the Public Utility Holding Company Act, and the legislative history of the Mineral Leasing Act), but that Congress chose not to impose the common carrier obligations.

CCEM also says that the duties the Commission imposed on the gas industry and those in the NOPR are not common carriage in any event. According to CCEM, a common carrier must carry all goods offered (citing *Am. Trucking Assoc. v. Atchison, T. & S.F. Ry. Co.*, 387 U.S. 397, 406 (1967)). Finally, CCEM cites *Stephenson v. Binford*, 287 U.S. 251, 265-66 (1932), where the Supreme Court held that obligations that are typical of common carriers can be imposed on contract motor carriers.

CCEM further disagrees with EEI's argument that the enactment of section 211 was a disavowal of any other Commission authority to order transmission.

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ELCON also disagrees with EEI's claim that the Energy Policy Act undermines the Commission's pre-existing section 205 and 206 authority. It states that the savings clause

in section 212(e) of the FPA, as amended, explicitly expresses Congress' intention not to undermine the Commission's pre-existing authority and that the legislative history contains nothing to suggest otherwise.

Similarly, in response to those who argue that section 211 is the only source of authority for the Commission to order transmission, NIEP argues that sections 211 and 212 serve purposes different from section 206. It says that the Commission's authority to order transmission in the "public interest" under sections 211 and 212 is not synonymous with its authority to order transmission as a remedy for undue discrimination under section 206; the two standards are complementary but distinct:

Although broadly applicable, the Commission's ability to order wheeling under sections 211 and 212 is carefully limited by a number of procedural provisions. Foremost among these is the requirement that the wheeling may be ordered only upon a specific application for transmission services. FERC's authority to act in the public interest is thus confined to the individual case.

By contrast, FERC's remedial powers under Section 206 can be exercised upon a finding of unjust, unreasonable or unduly discriminatory or preferential practices. Once that finding has been made, however, the form and substance of the remedy is left entirely to the FERC's discretion. If FERC deems it necessary, FERC may adopt generally applicable rules or practices as a countermeasure to discriminatory acts, including ordering utilities to file generally applicable transmission tariffs.[227]

NIEP also points out that the legislative history does not address the Commission's authority to order transmission as a remedy for undue discrimination. It challenges the

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[227] NIEP Reply Comments at p.8.

interpretation of the legislative history advanced by some commenters.[228]

Next, NIEP defends the Commission's proposed findings that there is generally undue discrimination in the provision of transmission service. It notes that when an agency acts on an industry-wide basis, the agency does not have to make a finding as to each particular case.

Finally, NIEP responds to those who argue that *AGD* is not on point. It notes that the *AGD* court discussed electric cases and emphasizes the court's statement that the NGA "fairly bristles with concern for undue discrimination"—a statement that is equally true of the FPA.

TDU Systems responds to the argument that *Otter Tail* is a broad constraint on the Commission's authority to order transmission.[229] At issue in that case, it argues, was the reach of the Sherman Act, not of FPA sections 205 and 206. Similarly, it argues, the *Florida Power* case is not on point, and the court there specifically said that it was not deciding whether the Commission could have ordered wheeling as a

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228 NIEP explains that

> "[w]hile much has been made of the Senate report accompanying S.2114, which subsequently became part of PURPA in 1978, that report does not illustrate an intent to limit FERC's authority to remedy undue discrimination under section 206. That report characterizes the Supreme Court's decision in *Otter Tail* as holding that "the Federal Power Act leaves open a gap in its failure to assign the FPC general authority to order wheeling *in this situation* * * *." The "situation" to which the Report refers is not discrimination, however. Instead, the statement appears to make reference to circumstances in which general public interest concerns, such as reliability, efficiency and competition, are at stake. Thus, Senate Report 2114 is simply not a limitation on the Commission's remedial powers under Sections 206."
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> NIEP Reply Comments at p.8-9 (citations omitted).

229 *See also* Entergy.

remedy for anticompetitive activities. Moreover, TDU Systems asserts that EEI's use of a quote from a single Senator should carry no weight, since it is a well-established principle of statutory construction that such statements have little value. Finally, it points out that the *AGD* court itself did not view *Otter Tail* or other electric precedent as forbidding the Commission to order wheeling as a remedy for undue discrimination.

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Entergy asserts that Congress's refusal to require utilities to provide transmission as common carriers or whenever it is in the public interest was merely a decision not to give the Commission general authority to order wheeling, without regard to undue discrimination. Thus, the *Otter Tail* language concerning the absence of a common carrier requirement does not demonstrate that Congress meant to limit the Commission's authority to remedy undue discrimination.

ELCON disputes EEI's reading of NYSEG, noting that the NYSEG court explicitly stated:

> Nor do we suggest that the Commission is powerless to review a wheeling agreement under section 206 without following the requirements of sections 211 and 212.[230]

TAPS discusses numerous cases, including the primary cases relied upon by the Commission, and disposes of *NYSEG* by stating that it is no longer good law, if it ever was.

Commission Conclusion

There can be no question that the Commission has the authority to remedy undue discrimination. Sections 205 and 206 of the FPA mandate that we ensure that, with respect to any transmission in interstate commerce or any sale of electric energy for resale in interstate commerce by a public

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[230] ELCON Initial Comments at p. 7 (quoting NYSEG at p. 403).

utility, no person is subject to any undue prejudice or disadvantage. Under these sections, we must determine whether *any* rule, regulation, practice, or contract affecting rates for such transmission or sale for resale is unduly discriminatory or preferential, and we must disapprove those contracts and practices that do not meet this standard. Our discretion is at its zenith in fashioning remedies for undue discrimination.[231]

Some commenters, however, challenge our authority to order industry-wide non-discriminatory open access as a remedy for the undue discrimination we have found in the industry. As summarized above, they essentially assert that we are prohibited by court precedent, the legislative history of the FPA, and sections 211 and 212 of the FPA from ordering wheeling as a remedy for undue discrimination. We disagree and conclude that we have the authority—indeed, a responsibility—to require non-discriminatory open access transmission as a remedy for undue discrimination.

AGD and Legislative History

The court decision in *Associated Gas Distributors v. FERC* provides powerful support for our ability to order industry-wide non-discriminatory open access transmission in the electric industry as a remedy for undue discrimination. As discussed in detail above, *AGD*, which is the only decision to have addressed the Commission's authority to remedy undue discrimination by requiring open access, upheld our authority under section 5 of the NGA (the parallel to section 206 of the FPA) to require open access in the natural gas industry. The rationale supplied by the *AGD* court applies equally to the FPA and our responsibility to eliminate undue discrimination in the electric industry.

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231 *See, e.g.*, Niagara Mohawk *Power Corporation v. FPC*, 379 F.2d 153, 159 (D.C. Cir. 1967).

Those who challenge the Commission's legal authority to remedy undue discrimination face the same difficulty that parties faced in seeking to overturn open access in the natural gas industry—they "can point to no language in the [FPA] barring the Commission from imposing common carrier status on [public utilities], and certainly none barring it from imposing upon the [public utilities] a specific duty that happens to be a typical or even core component of such status."[232] Instead, as was unsuccessfully attempted in the *AGD* proceeding, they seek to overcome the statutory silence primarily by means of legislative history. However, as the *AGD* court explained, legislative history is not even relevant, because

> courts have no authority to enforce principles gleaned solely from legislative history that has no statutory reference point.[[233]] Here, as the court found with respect to the NGA, the legislative history of the FPA "provides strong support only for the point that Congress declined *itself to impose common carrier status on [public utilities]* * * * *It affords weak—*

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> almost invisible—support for the idea that the Commission could under no circumstances whatsoever impose obligations encompassing the core of a common carriage duty."[234]

Commenters focus on the following statement in the *AGD* decision to support the argument that, because Congress did not expressly reject common carriage under the

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232 *AGD*, 824 F.2d at p. 997.

233 *Id.* (quoting *IBEW, Local No. 474 v. NLRB*, 814 F.2d 697, 712 (D.C. Cir. 1987) (emphasis deleted by court from original)).

234 *Id.* (emphasis added).

NGA, but did reject it under the FPA, a different outcome in this proceeding is required:

> we note that the legislative history of the two acts is, on this point, materially different. In its deliberations on the bill that ultimately emerged as the Federal Power Act, Congress considered and rejected a provision that would have "empowered the Federal Power Commission to order wheeling if it found such action to be 'necessary or desirable in the public interest.' " (citing *Otter Tail*) (quoting S. 1725, 74th Cong., 1st Sess.). The evidence as to the NGA (surveyed above) is less direct: it consists exclusively of various occasions on which Congress did not adopt proposals actually making the natural gas pipelines into common carriers.[235]

The above statement, however, does not preclude the *AGD* court's decision on our broad authority to remedy undue discrimination in the gas industry from applying equally in the electric industry. Clearly, the court did not say that. As discussed below, we believe the statement focuses on a distinction in the legislative histories that is not meaningful.

First, whether or not a material difference exists in the respective legislative histories of the NGA and FPA, the fact remains that the crucial findings of the *AGD* court were that: (1) "Congress declined *itself* to impose *common carrier* status" (emphasis added) and (2) there is no "support for the idea that the Commission could under no circumstances whatsoever impose obligations encompassing the core of a common carriage duty."[236] These findings apply equally to

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[235] *Id.* At p. 998-99.

[236] *Id.* At p. 997. We also note that the contract carriage obligation we are imposing is easily distinguished from the common carrier obligation Congress chose not to adopt. As discussed *infra*, the common carrier provisions rejected by Congress would have required transmission for

the FPA. Simply stated, statutory silence cannot be overcome by means of legislative history—even if the legislative history in fact indicated that Congress "rejected" legislative imposition of common carrier status under the FPA, but "did not adopt" it under the NGA. In either event, nothing in the statute or legislative history suggests that Congress concluded that the Commission could under no circumstances impose open access as a remedy to undue discrimination.

Moreover, the legislative history of the bills containing the FPA and the NGA, taken as a whole, suggests that the distinction drawn in *AGD* between the legislative histories of the NGA and the FPA is not meaningful. The legislation that was to become the FPA originally included provisions regulating both electric power and natural gas. As originally proposed, the legislation contained *identical* common carriage language for both public utilities and natural gas pipelines.

With respect to the FPA, the Supreme Court explained in *Otter Tail* that

> [a]s originally conceived, Part II would have included a "common carrier" provision making it "the duty of every public utility to * * * transmit energy for any person upon reasonable request * * *." In addition, it would have empowered the Federal Power Commission to order wheeling if it found such action to be "necessary or desirable in the public interest." H.R. 5423, 74th Cong., 1st Sess.; S. 1725, 74th Cong. 1st Sess. These provisions were eliminated to preserve "the voluntary action of the utilities." S.Rep. No. 621,

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"any person" upon reasonable request. This would have included retail purchasers.

74th Cong., 1st Sess., 19.[237]

The language paraphrased by the Supreme Court was from Title II of the initial bill proposing the Public Utility Holding Company Act. The entire sections from which the paraphrased language came are as follows:

> SEC. 202. (a) It shall be *the duty of every public utility* to furnish energy to, exchange energy with, and *transmit energy for any person upon reasonable request* therefor; and to furnish and maintain such services and facilities as
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> shall promote the safety, comfort, and convenience of all its customers, employees, and the public, and shall be in all respects adequate, efficient, and reasonable.
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> SEC. 203. (b) Whenever the Commission after notice and opportunity for hearing finds such action *necessary or desirable in the public interest*, it may by order direct a public utility to make additions, extensions, repairs, or improvements to or changes in its facilities, to establish physical connection with the facilities of one or more other persons, to permit the use of its facilities by one or more other persons, or to utilize the facilities of, sell energy to, purchase energy from, transmit energy for, or exchange energy with, one or more other persons. Where any such order affects two or more persons, the Commission may prescribe the terms and conditions of the arrangement to be made between such persons, including the apportionment of cost between them and the compensation or reimbursement reasonably due to any of them.[238]

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237 *Otter Tail*, 410 U.S. at p. 374.

238 H.R. 5423, 74th Cong., 1st Sess., 32 (emphasis added).

This initial bill proposing the Public Utility Holding Company Act also included a Title III that was intended to regulate the transmission and sale of natural gas. Sections 303(a) and 304 of Title III included the *identical* common carrier language paraphrased by the Supreme Court and included in sections 202(a) and 203(b) of Title II.[239] After further deliberations, Congress rejected the above-quoted language in Title II and eventually adopted a Title II that did not include any common carrier language. On the other hand, Title III (addressing regulation of natural gas) was not reported out of committee, but reemerged in the next year.[240] The bill that reemerged did not contain the common carrier language that was in the original Title III. However, as Congress had just debated the common carrier issue in enacting electric power regulation, it is not surprising that Congress did not engage in debating the very same issue in enacting natural gas regulation.

Because of the timing of the legislation involving the FPA and the NGA and the logical nexus between the two acts, we conclude that there is in fact no material difference as to this issue in the legislative histories of the two acts.

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239 *Id.* at p. 44.

240 In the debate on the subsequent bill to regulate natural gas, Congressman Cole explained:

> Mr. Chairman, the House should realize that the measure we are dealing with today is of extreme importance, more so than the attendance and the time taken in the discussion would seem to indicate. It is the culmination of one of the most far-reaching, intensive studies of the Federal Trade Commission I assume that that Commission ever conducted, and last year found a place in not identical language but very similar in the Rayburn bill, the famous holding-company bill, as part 3 thereof. Our committee eliminated part 3, as members will recall, and saved it for a separate measure reported out as it was last year, which was not considered by the House, but is here today in improved form.

81 Cong. Rec. H6724 (daily ed. July 1, 1937).

Both initially included identical common carrier language, and the language was removed from both. As to both acts, Congress chose not to impose common carrier obligations on the electric or natural gas industries, but gave the Commission the authority and responsibility to eliminate undue discrimination in both industries. Consequently, as open access was found to be a proper remedy for undue discrimination in the natural gas industry, it is also a proper remedy for undue discrimination in the electric industry.

As the *AGD* court noted with respect to the Commission's powers and duties under the NGA, Congress explicitly gave the Commission the authority to eradicate undue discrimination under the FPA. That explicit power and duty provided by Congress cannot be invalidated solely on the ground that Congress chose not to impose statutory common carrier status on public utilities or did not explicitly authorize the Commission to do so.[241] As the *AGD* court explained, this would "turn [] statutory construction upside down, letting the failure to grant a general power prevail over the affirmative grant of a specific one."[242]

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Other Case Law

A number of commenters argue that the Commission misinterpreted the other cases discussed in the NOPR with respect to our authority to order non-discriminatory open access transmission. We disagree. As demonstrated above, not one of the cases put forth by commenters holds that we cannot remedy undue discrimination by requiring public

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241 *AGD*, 824 F.2d at p. 998.

242 *Id.*

utilities to provide non-discriminatory open access transmission.[243]

AGD is the *only* case in which a court specifically addressed our authority to order open access transmission as a remedy for undue discrimination. Its favorable finding with respect to our action under section 5 of the NGA directly supports our ordering non-discriminatory open access transmission under section 206 of the FPA.

Authority to Act by Rule

We disagree with those commenters that assert that we may find and remedy undue discrimination only through case-by-case adjudications and are prohibited from making a generic determination of undue discrimination through a rulemaking. First, there is no question that it is within our discretion whether we act through rule or through case-by-case adjudications.[244] The *AGD* court specifically rejected a similar argument that the Commission erred in requiring open access transportation tariffs without first finding that each individual pipeline's rates were unlawful. The *AGD* court held that "[t]he Commission is not required to make individual findings if it exercises its §5 authority by means of a generic rule."[245]

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[243] *See FERC Statutes and Regulations* at pp. 33,053-56. We further note that the *AGD* court did not discuss the *NYSEG* decision at all. Indeed, the *NYSEG case did not involve any allegations of undue discrimination and any discussion of section 206 by the court was dictum.*

[244] See, e.g., NLRB v. Bell Aerospace Company, 416 U.S. 267, 293 (1974) (*citing SEC v. Chenery Corporation*, 332 U.S. 193, 202-03 (1947)). *See also Heckler v. Campbell*, 461 U.S. 458, 467 (1983) (even where enabling statute requires a hearing to be held, agency may rely on its rulemaking authority); *Panhandle Eastern Pipeline Company v. FERC*, 907 F.2d 185, 187-88 (D.C. Cir. 1990). Under section 403 of the DOE Act, 42 U.S.C. 7173, the commission is authorized at its discretion to initiate rulemaking proceedings.

[245] *AGD*, 824 F.2d at p. 1008.

We have identified a fundamental generic problem in the electric industry: owners, controllers and operators of monopoly transmission facilities that also own power generation facilities have the incentive to engage, and have engaged, in unduly discriminatory practices in the provision of transmission services by denying to third parties transmission services that are comparable to the transmission services that they are providing, or are capable of providing, for their own power sales and purchases. These practices drive up the price of electricity and hurt consumers. Furthermore, the incentive to engage in such practices is increasing significantly as competitive pressures grow in the industry. It is within our discretion to conclude that a generic rulemaking, not case-by-case adjudications, is the most efficient approach to take to resolve the industry-wide problem facing us.

b. Undue Discrimination/Anticompetitive Effects

Initial Comments

A number of commenters allege that the Commission has failed to meet its burden of proving industry-wide discrimination.[246] They assert that the Commission has provided only a few unsubstantiated allegations of discrimination, which do not represent the current conditions in the electric industry, or that the Commission has not shown that all electric utilities have unduly discriminated. Some attack the NOPR's incorporation by reference of the unsubstantiated allegations of discrimination set forth in a petition for rulemaking filed on February 16, 1995 by the Coalition for a Competitive Electric Market (CCEM).[247]

EEI argues that the allegations of discrimination in the NOPR must be considered in light of the fact that: (1) All

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246 *E.g.* EEI, Ohio Edison, PA Com, BG&E, NY Com, Minnesota P&L, Carolina P&L.

247 *E.g.*, EEI, BG&E.

tariffs currently on file have been found by the Commission not to be discriminatory; (2) more than 30 utilities have voluntarily filed open access tariffs, which belies any assertion of widespread discrimination in the industry; and (3) transmission disputes are rare, with only 19

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section 211 proceedings having been filed in the last three years.[248] EEI concludes that the Commission's allegations of discrimination do not rise to the level of "extreme circumstances" found by the court in the natural gas industry in *AGD*.

EEI adds that the Commission's proposal to act under section 206 is itself discriminatory because it applies only to public utilities and does not reach all transmission-owning utilities.[249] If reciprocity is designed to resolve this problem, EEI believes that reciprocity should also be "effective for public utilities." Furthermore, EEI argues that the failure of a public utility to provide to others a service that it does not provide itself is not evidence of discrimination, and that inclusion of such a provision actually results in preferential treatment for transmission users.

NE Public Power District alleges that the NOPR does not contain a single reference to any actual discrimination or anticompetitive conduct by any publicly owned utility.

Salt River asserts that the Commission is required to consider all elements of an antitrust analysis before reaching a conclusion that market power exists in the transmission system and that we have failed to do so.[250] It concludes that the NOPR "constitutes an attempt to legislate a remedy for an

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248 *See also* Ohio Edison.

249 *See also* SCE&G.

250 Salt River Initial Comments at p. 5-6 (referencing an attached legal memorandum of Donald A. Kaplan).

evil that has not been, and cannot be, lawfully found to exist on a wholesale basis among utilities that own and operate integrated generation and transmission systems."[251]

PA Com argues that the Commission's request for examples of discriminatory behavior is a "tacit admission as to the paucity of evidence of discriminatory practices by transmission owning utilities." NY Com argues that the "Commission's lack of a record basis for its proposed findings is legally suspect because courts in two cases have held that the Commission cannot proceed with open access transmission tariffs absent record findings of specific anticompetitive conduct."[252]

Finally, EEI claims that even if the Commission has proven its allegations of discrimination, we have failed to meet the requirements of section 206 of the FPA.[253] According to EEI, the Commission cannot find, without an adjudicatory hearing, that the rates on file are unlawful and order replacement rates.[254] The Commission's proposed procedure would unlawfully place the burden of justifying existing rates on the utilities.

Reply Comments

A number of commenters provide instances of discriminatory behavior they have faced over the years. NCMPA describes difficulties it has faced in dealing with CP&L, including a situation where CP&L allegedly impeded

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251 Salt River Initial Comments at p. 6.

252 NY Com Initial Comments at 16-18 (discussing *FPL* and *Cajun*).

253 *See also* Southern.

254 *See also* Southern.

NCMPA's use of transmission access through CP&L's control of dispatching.[255]

AMP-Ohio alleges that Toledo Edison refused to transmit emergency power on a buy-sell basis to certain AMP-Ohio members even though Toledo Edison's system was not constrained. Instead, AMP-Ohio alleges, Toledo Edison bought the power and resold it to AMP-Ohio at a higher rate.

APPA challenges EEI's claim that there is no substantial evidence of undue discrimination in transmission. It suggests that nineteen instances of transmission disputes being filed since the Energy Policy Act was enacted is ample evidence of undue discrimination. Moreover, according to APPA, reported abuses are only the tip of the iceberg.

CCEM responds to the argument raised by EEI and others that there is no showing of extreme circumstances of discrimination in the electric industry such as the AGD court noted in the gas industry. It says that these circumstances are present and gives numerous examples; it does not identify the specific utilities because "it is the experience of * * * [our] members that nearly all transmission owners retaliate

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* * *" against anyone who complains. Moreover, in answer to EEI's statement that transmission disputes are rare, CCEM states that since most of the competition is in the short-term market, it has not been worthwhile to file complaints. The examples provided by CCEM include: (1) refusal by a California public utility to offer firm service; (2) refusal by control area utilities in Texas to offer ancillary services to a power marketer, with the result that one of the utilities won the bid, even though it did not have the lowest price; (3) non-utilities in ERCOT being unable to compete to meet short-

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255 We note that CP&L raised legal objections to our authority to implement this rule.

term requests for economy energy because they were required to schedule by noon of the preceding day, while utilities did not subject themselves to such a scheduling requirement; (4) power pool or control area information requirements, particularly in the northwest part of WSPP, that force non-utilities to reveal commercially sensitive information; the transportation operator has then revealed the information to its own or its affiliate's sales arm, which "steals" the deal; (5) a northeast power pool that refused to wheel out even though capacity was available on the grounds that sending power out of the pool would drive up prices in the pool (hoarding); (6) a power marketer that asked a utility to provide transmission, whereupon the utility bought up certain transmission capacity necessary for the marketer to reach its buyer, thus blocking the path—this was possible because the utility was able to locate the purchaser based on commercially sensitive information the marketer had to give the utility when the marketer asked for transmission; (7) a common contracting practice among utilities restricting the use of interconnections to themselves, particularly in the Southwest Power Pool, MAPP, and MAIN; (8) utilities overstating the cost of improvements (gold-plating) and thus discouraging service. CCEM also responds to each of EEI's criticisms of CCEM's examples of undue discrimination submitted in its February 16, 1995 petition and argues that its examples of undue discrimination are unrebutted.

Brownsville asserts that

> while PUB [Brownsville] must pay multiple distance-based and pancaked transmission rates to engage in transactions with the non-ERCOT universe, El Paso Electric would have *received* transmission payments from its merger partners while gaining *free* transmission access to buy and sell within ERCOT. CSW presently walls other ERCOT utilities off from participation in the Western Systems Power Pool, while its ERCOT

> subsidiaries, CPL and WTU, share in the benefits of their non-ERCOT affiliates' WSPP memberships via the preferential terms of the CSW Operating Agreement. CSW treats its own inter-affiliate central dispatch as having a higher priority than third-party economy energy transactions, with the result that CPL not infrequently crowds PUB out of the economy market.[256]

Wisconsin Municipals states that its members have been fighting transmission battles for years and sets forth five examples of the sort of difficulties it has experienced in attempting to obtain transmission rights. For example, it explains that Wisconsin public utilities have resisted an effort by the state commission to achieve comparability of use of transmission. Wisconsin Municipals also explains a situation where "if WPPI continued to purchase its power from WPSC, it would pay WPSC $843,840 annually for transmission service: if it purchases power off system from WP&L (one of WPSC's competitors), WPPI would pay WPSC $1,774,224 for transmission service to the exact same load."

TAPS sets forth additional examples of undue discrimination, including refusals to wheel even in the face of Nuclear Regulatory Commission (NRC) nuclear license conditions requiring wheeling, and Northeast Utilities' refusal to provide transmission to a QF even though it had indicated to the Commission that it would provide such transmission in order to obtain Commission approval of its proposed merger with Public Service Company of New Hampshire.

NIEP sets forth ten examples of undue discrimination that its members have experienced in seeking access to transmission service at reasonable terms and conditions.

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256 Brownsville Reply Comments at p. 2-3 (emphasis in original).

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Some commenters challenge these claims of undue discrimination. For example, Carolina P&L responds to NCMPA #1's example of obstruction by Duke in accommodating energy sales from the jointly-owned Catawba Plant. Carolina P&L explains that NCMPA #1's proposal "would require Duke to provide its own generation resources on behalf of NCMPA #1 in order to support a bulk power sale when NCMPA #1's own resource capacity and energy are not sufficient for the sale." Carolina P&L argues that this is backstanding that goes beyond the scope of any ancillary service the Commission has proposed and would be entirely inappropriate "to compel the Transmission Provider to sell power to its Transmission Customer for resale on the bulk power market."

Duke also responds to NCMPA #1's claim of discrimination and asserts that NCMPA #1's claim is not relevant to the NOPR proceeding, but is a specific contractual claim that should be pursued pursuant to the terms of its contract.

Commission Conclusion

We conclude that unduly discriminatory and anticompetitive practices exist today in the electric industry and, more importantly, that such practices will increase as competitive pressures continue to grow in the industry, unless the Commission acts now to prevent such practices.[257] It is in the economic self-interest of transmission monopolists, particularly those with high-cost generation assets, to deny transmission or to offer transmission on a basis that is inferior to that which they provide themselves.

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257 While many public utilities have filed some form of open access tariff (often in response to our proposed rule), we believe that many of the remaining utilities will not voluntarily open their systems absent a final rule. *See also* note 266.

The inherent characteristics of monopolists make it inevitable that they will act in their own self-interest to the detriment of others by refusing transmission and/or providing inferior transmission to competitors in the bulk power markets to favor their own generation, and it is our duty to eradicate unduly discriminatory practices. As the *AGD* court stated: "Agencies do not need to conduct experiments in order to rely on the prediction that an unsupported stone will fall."[258]

We set forth examples in the NOPR of undue discrimination that we believe are occurring in the electric industry and invited commenters to identify any discrimination that they may have experienced. In response, commenters presented numerous additional examples of undue discrimination, which are summarized above, and we set forth below further examples of undue discrimination that have been raised in cases before the Commission.

Many of the examples of discriminatory behavior that have been brought to our attention do not name the specific utilities involved, and many are allegations that are not proven. However, we do not believe that this undermines our finding of unduly discriminatory practices by transmission owners and controllers. We believe that it is only natural that potential transmission customers with an interest in participating in electric markets will be reluctant to name names for fear of being shut out of those markets. CCEM, which identified a wide array of discriminatory behavior its members have experienced, explained that

> [w]e do not identify the specific utilities in each example because it is the experience of CCEM members that nearly all transmission owners retaliate by cutting off all communications with anyone that challenges or complains about the rates, terms or conditions at which the owner offers access

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[258] *AGD*, 824 F.2d at p. 1008.

> to its system. Inasmuch as most of the competitive commerce in electric power today is in short-term markets, it is typically not worth the effort of CCEM members or other transmission-dependent entities to file a complaint with the Commission's enforcement staff or in the courts in connection with a transmission owner's discriminatory practices. The deal is lost well before a complaint can be processed and ruled upon.[259]

Other examples of discriminatory behavior have also been raised in proceedings before the Commission. As we

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explained in detail in the NOPR, transmission-owning utilities have discriminated against others seeking transmission access in a variety of ways, most often subtly and indirectly.[260] For example, delaying tactics have been used to frustrate access. The history of Pacific Gas and Electric Company's (PG&E) attempt to avoid its commitments made to the California owners of the California-Oregon Transmission Project (COTP) is a prime example. The owners had originally planned the COTP to have its southern terminus at the Midway station with Southern California Edison. PG&E convinced them to terminate the project instead at PG&E's Tesla station and indicated that PG&E would provide transmission service the rest of the way south to Midway. PG&E promised this service in 1989 (in Principles). PG&E spent the next four years filing substitute provisions for what it had promised in the Principles.[261] Additional allegations of discriminatory

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259 CCEM Initial Comments at p. 18-19. See also NIEP Reply Comments at p. 13 n.31.

260 *FERC Statutes and Regulations* at p. 33,072.

261 *See Pacific Gas and Electric Company*, 65 FERC ¶61,312, at p. 62,428-30 and n.22, *remanded on other grounds, Pacific Gas & Electric*

behavior are set forth in Appendix C, which includes allegations made under oath in proceedings at the Commission and allegations made in pleadings and other documents before the Commission.

In addition, to date, the Commission has received 28 section 211 transmission requests.[262] Applicants submit section 211 transmission requests when the transmission provider refuses to provide the requested transmission service. For example, American Municipal Power-Ohio, Inc. (AMP-Ohio) requested Ohio Edison Company (Ohio Edison) to establish additional delivery points to certain of AMP-Ohio's members and to permit the addition of delivery points in the future upon AMP-Ohio's request. Ohio Edison refused AMP-Ohio's request, claiming that it was not a proper request under section 211 because it already provided wholesale transmission to the municipal utilities at issue. In a proposed order, the Commission disagreed with Ohio Edison and ordered Ohio Edison to provide the requested additional delivery points and to entertain future requests by AMP-Ohio for specific delivery points.[263]

Many of the examples of discriminatory actions we are seeing in the electric industry are similar to those we saw in the gas industry. Given our experience, we find that these examples of discriminatory actions are credible and well-founded. Thus, we conclude that there is more than sufficient reason to believe that transmission monopolists currently engage in unduly discriminatory practices, and that they will continue to engage in unduly discriminatory practices, unless we fashion a remedy to eliminate their ability and incentive

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Company v. FERC, No. 94-70037 (9th Cir. June 23, 1994) (unpublished opinion), *order on remand*, 69 FERC ¶61,006 (1994).

[262] A list of section 211 applications and the status of each is attached as Appendix A.

[263] *American Municipal Power-Ohio, Inc. v. Ohio Edison Company*, 74 FERC ¶61,086 (1996).

to do so. In light of the competitive changes occurring in today's electric industry, we believe that the only effective remedy is non-discriminatory open access transmission, including functional unbundling and OASIS requirements, and that it is within our statutory authority to order that remedy.

Further, we disagree with the argument that we are limited to applying a traditional antitrust analysis in determining whether market power exists in the transmission system. While we must take antitrust concerns into consideration in exercising our responsibilities under the FPA, we are not an antitrust court, and our responsibilities are not those of the Department of Justice.[264] We have analyzed the incentives and practices of monopoly transmission owners and controllers in light of the statutory standards and directives of the FPA and, based on our findings, have properly concluded that there is a generic problem that must be remedied.

The Commission also recognizes, as some commenters suggest, that we have, in the past, permitted utilities to file tariffs containing restrictions on transmission

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service that we are now finding to be unduly discriminatory in this rule and that we found unduly discriminatory in cases since our decision in *AEP*. However, it is entirely appropriate, and indeed necessary, that our application of the FPA's undue discrimination standard evolve over time and adapt to the changing circumstances in the industry. Our prior willingness to tolerate the use of monopoly power over transmission to maintain and aggregate the utility's market

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[264] See, e.g., Gulf States Utilities Company v. FPC, 411 U.S. 747, 758-60 (1973); *FPC v. Conway Corporation*, 426 U.S. 271, 279 (1976); *Northern Natural Gas Company v. FPC*, 399 F.2d 953, 960 (D.C. Cir. 1968).

power over generation occurred in the context of an industry structured largely as vertically integrated regulated monopolies that supplied all facets of utility service—power supply, transmission, and distribution—as a single monopoly service. Competition generally was not meaningfully available as a means to discipline prices and consumer interests were best served by improving efficiencies of the integrated utilities, subject to cost-based regulation.

Today, the circumstances of the industry are radically different. As explained in detail in Section III, a series of significant economic, regulatory, and technical changes in the power industry has introduced the promise of competitively priced power supplies. The profile of electric power suppliers has expanded to include not just the power supply arms of traditional utilities, but also independent power suppliers, affiliated utility power suppliers selling into territories of other franchise utilities, and power marketers.[265] This offers the promise of an increasingly competitive commodity market in electric power, in which significant benefits to consumers can be achieved. In the context of an emerging competitive market in generation, discriminatory practices that once did not constitute *undue* discrimination must be reviewed to determine whether they are being used to prevent the benefits of competition in generation from being achieved. Here we find conclusively that they are, and use our remedial authority to ensure that they can no longer occur.[266]

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[265] We note that there are now 14 power marketers that are affiliated with public utilities.

[266] We take note of EEI's comments that, at the time of the comments, 30 utilities had filed open access tariffs. They argue, therefore, that the rule is unnecessary. Since their comment was filed, the number of utilities filing some form of an open access tariff has risen to 106. However, while some of these tariffs are based on the NOPR pro forma tariffs, many of these tariffs fall significantly short of the tariff requirements of both the NOPR and this Rule. Even if the tariffs met

c. Section 211

Comments

Various commenters contend that the enactment of section 211 in essence either removed any authority the Commission might have had under sections 205 and 206 or demonstrates that Congress did not believe the Commission could order wheeling under those provisions.

These commenters assert that the legislative history of the FPA indicates that Congress specifically rejected giving the Commission authority to order wheeling under any circumstances.[267] They further contend that the legislative history of section 211 demonstrates that Congress viewed the authority it granted in section 211 as a strictly limited and entirely new authority for the Commission.[268] Specifically, EEI states that the legislative history of the Energy Policy Act confirms that the expanded authority provided under section 211 was not intended to grant the Commission blanket authority to order wheeling, even as a remedy for anticompetitive conduct. Similarly, Utilities For Improved Transition argues that the legislative history shows that Congress specifically intended to preclude the Commission from ordering tariffs of general applicability under any circumstances. In addition, EEI points to testimony provided

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these requirements, the Rule is still needed to complete the task of eliminating undue discrimination by all public utilities and assuring, to the extent possible, a nationwide open access transmission grid. Indeed, a number of these tariffs were filed for the purposes of securing authority to market power *competitively*. This underscores markedly our fundamental conclusion that prior practices of using monopoly power over transmission to preserve market power over electricity sales has no place in today's industry and must be eliminated to get the benefits of competition to the customers we are required to protect under the FPA.

267 E.g., EEI, VA Com, Ohio Edison Southern, Utilities For Improved Transition, BG&E.

268 *See also* NM Com.

by a Commission staff witness before the Subcommittee on Energy and Power of the House Committee

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on Energy and Commerce in which EEI claims that "she suggested that an affirmative statement that the Commission had the power to require wheeling on its own motion should be included, possibly in section 211." EEI maintains that such suggestion was rejected by Congress in favor of allowing the Commission to order wheeling only upon application.

Detroit Edison, asserting that Cajun stands for the proposition that the agency must follow Congressionally mandated procedures, claims that the Commission can order transmission only after going through the procedures of section 211. Detroit Edison also argues that the Commission should incorporate into the final rule the various safeguards of section 211, such as the requirement that the utility receive prior notice, the requirement that transmission service be in the public interest, and the requirement that existing service not be displaced. FL Com further asserts that it was Congressional intent in the Energy Policy Act for wheeling to be ordered on a case-by-case basis pursuant to section 211.[269]

EEI argues that the enactment of section 211 eliminated any authority the Commission had under sections 205 and 206 to order wheeling as a remedy for undue discrimination. It alleges that the Commission failed to discuss the NYSEG case concerning the relationship between section 211 and sections 205 and 206 in any meaningful way. According to

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[269] *See also* Salt River. Moreover, FL Com states that the Commission should modify its hearing process to better accommodate state PUC participation by: (1) Holding hearings in the affected state; (2) teleconferencing; (3) making free transcripts available to states; and (4) substantially deferring to a state when the state commission has held a hearing on an issue in the case.

EEI, the NYSEG court concluded that section 211 "was the only appropriate vehicle under which the Commission could order NYSEG to wheel power for the municipality."[270] EEI further resorts to canons of statutory construction to conclude that "section 211 must be given effect as the more specific provision and must be interpreted to limit the scope of sections 205 and 206."[271] In addition, EEI asserts that "Congress had an opportunity to reject the NYSEG court's interpretation of the scope of sections 205, 206 and 211, but instead amended section 211 in a manner that is consistent with the view that mandatory wheeling is to be governed exclusively by section 211." Dayton P&L raises similar arguments. It notes the savings provision in section 212(e), but says that Congress "would have been more specific if it understood that the Commission already had the authority to order wheeling under FPA sections 205 and 206. * * *"[272]

Associated EC argues that the NOPR appears to exceed the Commission's authority in that it proposes that "wholesale *buyers* and sellers have 'equal access to the transmission grid.' " It asserts that "Section 211(a), however, makes mandatory transmission service available only to

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270 EEI quoted the following language from NYSEG:

> Nor do we suggest that the Commission is powerless to review a wheeling agreement under section 206 without following the requirements of sections 211 and 212. If, after a hearing as required by section 205, the Commission determines that a particular rate, charge or condition is unreasonable, it can order a modification. But where, as here, the modification amounts to an order requiring wheeling, it must be preceded also by determination in accordance with sections 211 and 212. Simply put, we will not allow the commission to do indirectly without compliance with the statutory prerequisites, what it could not do directly without such compliance (*citing Richmond Power & Light*).

271 *See also* VA Com.

272 *See also* Carolina P&L.

'[a]ny electric utility, Federal power marketing agency or any other person generating electric energy for sale for resale.' »[273]

NE Public Power District argues that sections 211 and 212 of the FPA appear clearly to contemplate a case-by-case approach.[274] NE Public Power District adds that if the Commission believes sections

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211 and 212 are inconsistent with the public interest, it can ask Congress to modify those provisions. Allegheny adds that the Commission can order wheeling only under sections 211 and 212 on a company-specific basis and can use sections 205 and 206 only to evaluate the reasonableness of terms and conditions of voluntarily filed agreements or tariffs by public utilities.

Utilities For Improved Transition also claims that sections 211 and 212 override any authority the Commission might have had under sections 205 and 206 to order industry-wide open access. It cites the savings clause in section 212(e) of the FPA as limiting the Commission's authority to order transmission.[275] Utilities For Improved Transition argues at

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[273] This argument is puzzling. First, Section 211 does not control to whom access must be provided under sections 205 and 206. However, even if it did, Associated EC appears to misconstrue eligibility under section 211. An electric utility as defined in the FPA is any person or State agency (including any municipality) which sells electric energy. The definition does not say that electric energy must be re-sold at wholesale. Thus, an electric utility could be a wholesale *buyer* of transmission used to transmit energy for sale at either wholesale or retail.

[274] *See also* Allegheny.

[275] It states that:

> Section 212(e), however, provides that Sections 211 and 212 limit or impair the Commission's authority under "other provisions of law" (a phrase including, obviously, Sections 205 and 206). On the face of the statute—we say again for

some length that the NOPR does not meet the procedural and substantive standards of sections 211 and 212. It goes on to cite various passages from the legislative history of the Energy Policy Act as supporting the view that Congress intended to eliminate the Commission's authority to order industry-wide open access as a remedy for undue discrimination. According to Utilities For Improved Transition, these passages "unmistakably show a clear legislative intent to preclude the mandatory transmission that the Commission attempts here * * *."

Commission Conclusion

We disagree with those commenters that argue that the Energy Policy Act either eliminates our authority under section 206 to remedy undue discrimination by requiring non-discriminatory open access transmission or demonstrates that we never had any such authority. Nothing in sections 211 and 212 or in the legislative history of these sections indicates that Congress intended to eliminate the Commission's other, broader authorities under the FPA. Indeed, section 212(e) specifically provides:

> SAVINGS PROVISIONS.—(1) No provision of section 210, 211, 214, or this section shall be treated as requiring any person to utilize the authority of any such section in lieu of any other authority of law. Except as provided in section 210, 211, 214, or this section, *such sections shall not be construed as limiting or impairing any authority of the Commission under any other provision of law.*[276]

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emphasis: *on the face of the statute*—the Commission therefore does not have the authority to order transmission services outside the provisions of Sections 211 and 212."

Utilities For Improved Transition Initial Comments at p. 51 (emphasis in original).

276 16 U.S.C. §824k (emphasis added).

Utilities For Improved Transition's argument that the "Except as provided" clause limits or impairs the Commission's authority to order transmission service under sections 205 and 206 would make the savings provision meaningless. Moreover, such a reading would be entirely at odds with the underlying purposes of the Energy Policy Act. It would be ironic indeed to interpret the Energy Policy Act as eliminating our long-standing, broad authority to remedy undue discrimination, given the pro-competitive purpose of the statute.

The legislative history also provides no support for the arguments that sections 211 and 212 remove or prove the non-existence of the Commission's authority to remedy undue discrimination by requiring non-discriminatory open access transmission. In fact, virtually every bit of legislative history raised by commenters opposing the NOPR consists of various statements by Senator Wallop, an opponent of expanding transmission access under sections 211 and 212.[277] Such legislative history provides no insight into

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the meaning of a statute and is given little or no weight by the courts.[278]

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[277] In discussing the electricity provisions of the Energy Policy Act, Senator Wallop declared:

> It would be a mistake to take the presence of transmission access provisions in the Conference Report as a sign of change in position on my part or that of the Senate. I would have strongly preferred PUHCA reform without any transmission access provisions, as was the Senate position. However, in order to obtain the very significant benefits of PUHCA reform contained in the Senate bill, it was necessary to accept some of the House transmission access provisions.

138 Cong. Rec. S17615 (daily ed. October 8, 1992)

[278] See, e.g., Shell Oil Company v. Iowa Department of Revenue, 488 U.S. 19, 29 (1988) (*Shell*). In *Shell*, the Court declared:

The only other legislative history that commenters put forth is the testimony of a Commission staff witness, in 1992 hearings before the Subcommittee on Energy and Power of the House Committee on Energy and Commerce. According to EEI, the witness indicated that an affirmative statement that the Commission could require wheeling on its own motion "would be needed [in the Energy Policy Act] if Congress intends for the Commission to be able to deal with transmission on its own motion and thereby go further than simply dealing with industry proposals." EEI claims that this statement demonstrates that the expanded authority in the Energy Policy Act "was not intended to grant the Commission blanket authority to order wheeling, even as a remedy for anticompetitive conduct."

EEI's argument is misleading and disingenuous. It takes the witness's statements out of context, ignoring attendant testimony that "there are strong legal arguments that the Commission's obligation to protect against undue discrimination carries with it the authority to impose transmission requirements as a remedy for undue preference or discrimination," and the extensive legal argument, included in her testimony, in favor of that position—an argument that closely parallels the legal argument the Commission is relying on in this proceeding.[279] Indeed, in the

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This Court does not usually accord much weight to the statements of bill's opponents. "[T]he fears and doubts of the opposition are no authoritative guide to the construction of legislation." *Gulf Offshore Co. v. Mobile Oil Corp.*, 453 U.S. 473, 483 (1981) (*quoting Schwegmann Bros. V. Calvert Distillers Corp.*, 341 U.S. 384, 394 (1951)."

See also Sutherland Statutory Construction I §48.16 at p. 366.

[279] Hearings on H.R. 1301, H.R. 1543, and H.R. 2224 before the Subcommittee on Energy and Power of the House Committee on Energy and Commerce, 102d Cong., 1st Sess. (May 1,2 and June 26, 1991), Statement of Cynthia A. Marlette, Associate General Counsel, Federal Energy Regulatory Commission, Report No. 102-60 at p. 60 and 61-70. *See also Id.* At p. 106 ("I believe that we have substantial authority under

face of such explicit testimony from the staff of the agency required to implement the statute, had Congress intended to limit the Commission's remedial authority under section 206 when it amended section 211, we believe it would have explicitly done so in the language of the statute itself, or at least have indicated its intent to do so in the Conference Report on the Energy Policy Act.[280]

C. Comparability

1. Eligibility to Receive Non-Discriminatory Open Access Transmission

In the NOPR, the Commission proposed to define who is eligible to receive service under a non-discriminatory open access tariff as follows:

> A non-discriminatory open-access tariff must be available to any entity that can request transmission services under section 211.[281]

The Commission further explained that "[u]nder section 211, any electric utility, Federal power marketing agency, or any other person generating electric energy for sale for resale may request transmission services under section 211."[282]

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the existing case law to mandate access where necessary to remedy anticompetitive effects.").

[280] At the time Congress enacted amendments to FPA section 211, it was well aware that the Commission had unexplored authorities under sections 205 and 206 of the FPA to compel wheeling. The only explicit limitations it chose to impose on the Commission's wheeling authorities were those contained in sections 212(g) and (h), which provide that no order "under this Act" may be inconsistent with any State law governing retail marketing areas of electric utilities (section 212(g)), or be conditioned upon or require the transmission of electric energy directly to an ultimate consumer (section 212(h)).

[281] *FERC Statutes and Regulations* ¶32,514, at p. 33,083 (footnote omitted).

[282] *Id.* At p. 33,083 n.195.

Comments

PSNM believes that the NOPR properly defined customer eligibility. NIEP, on the other hand, believes that the proposed definition is too limited. It argues that the Commission should require public utilities to make transmission service available to all entities engaged in wholesale purchases or sales of power, not just to those "generating" power. Utility Working Group requests that the Commission

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clarify that eligibility is dependent not only on being the type of entity set forth in section 211, but on meeting the requirements of section 212(h) (Prohibition on Mandatory Retail Wheeling and Sham Wholesale Transactions) as well.[283]

We also received several comments related to the applicability of the rule to foreign entities. Canada states that the requirements for comparability and reciprocity should be implemented in a flexible manner to permit Canadian utilities to have fair and competitive access in the U.S. electricity market. Maritime requests that the Commission require Canadian utilities who wish to participate in the U.S. market to offer other utilities the same privileges they receive in the United States. Southwestern argues that transmission to a foreign country is in interstate commerce and that a utility should therefore accommodate this type of transmission request under its open access tariff. El Paso argues that the Commission does not have the authority to condition access to foreign countries, but states that if the Commission nevertheless exercises such authority it should do so on a case-by-case basis. Destec asserts that

the posturing of Ontario Hydro before U.S.

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[283] Section 212(h) (Prohibition on Mandatory Retail Wheeling and Sham Wholesale Transactions).

regulators pleading for open access and non-discriminatory transmission treatment—even for extra-territorial entities, should be met with a strong reply that such provisions should also be afforded transmission dependent entities on the Canadian side of the border. Ontario Hydro's aggressive pursuit of U.S. market opportunities while simultaneously blocking competitors through the control of their transmission assets can not be ignored.

Commission Conclusion

In the Final Rule pro forma tariff the Commission has modified the definition of "eligible customer" to address concerns that in some respects the NOPR definition was too limited and in other respects it was too broad. This includes amended language to clarify that any entity engaged in wholesale purchases or sales of energy, not just those "generating" electric power, is eligible. It also includes clarification that entities that would violate section 212(h) of the FPA (prohibition on Commission-mandated wheeling directly to an ultimate consumer and sham wholesale transactions) are not eligible. The language also has been modified to provide that foreign entities that otherwise meet the eligibility criteria may obtain transmission services. Further, it has been modified to provide for service to retail customers in circumstances that do not violate FPA section 212(h).[284]

Persons that would be eligible section 211 applicants also would be eligible under the open access tariffs. Section 211 applicants may be any electric utility, Federal power marketing agency, or any other person generating electric energy for sale for resale.

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[284] We emphasize that *any* transmission customer must follow prudent utility practices so as to assure reliability.

Section 3(22) of the FPA, as amended by the Energy Policy Act, defines "electric utility" to mean

> any person or State agency (including any municipality) which sells electric energy; such term includes the Tennessee Valley Authority, but does not include any Federal power marketing agency.

Thus, as we have previously noted, municipal utilities are electric utilities simply by the terms of the statute.[285] In addition, we have also found that cooperatives and marketers are electric utilities as defined in the FPA.[286] Other entities that fall within the definition include IOUs, IPPs, APPs, and QFs that sell electric energy.

We do not believe that entities that engage solely in brokering should be eligible. Such brokers do not take title to electricity and therefore do not engage in the sale of electric energy; nor do they generate electric energy for sale for resale.[287] [287]

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Although such brokers are not eligible under the tariffs, they will be able to arrange deals because they will have access to the OASIS of all public utilities and will be able to solicit

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[285] New Reporting Requirement Implementing Section 213(b) of the Federal Power Act and Supporting Expanded Regulatory Responsibility Under the Energy Policy Act of 1992, and conforming and Other Changes to Form No. FERC-714, Order No. 558-A, 65 FERC ¶61,324, at p. 62,451 n.12 (1993).

[286] Order No. 558, *FERC Statutes and Regulations* ¶30,980, at pp. 30,895-95, *reh'g denied*, 65 FERC ¶61,324 (1993) (cooperatives are electric utilities); *AES Power, Inc.*, 69 FERC ¶61,345, at p. 62,297 (1995) (power marketer is an electric utility, *i.e.*, a person "which sells electric energy").

[287] *See, e.g., Citizens Energy Corporation*, 35 FERC ¶61,198, at pp. 61,452-53 (1986).

information from the relevant transmission service providers under the terms of the applicable tariffs.

We clarify that foreign entities that otherwise meet the eligibility criteria must be eligible to receive service under the non-discriminatory open access transmission tariffs.[288] We are making this determination pursuant to our authority under section 206 of the FPA to remedy undue discrimination. As we explained in the NOPR, market power through the control of transmission can be used discriminatorily to block competition. Customers in the United States should not be denied access to cheaper supplies of electric energy, whether such electric energy is from a domestic source or a foreign source. By making non-discriminatory access available to foreign entities that otherwise meet the eligibility criteria, we are assuring that customers in the United States have access to as many potential suppliers as possible. This should result in increased competition and lead to customers paying the lowest possible prices for their electric energy needs. To the extent that such an entity obtains access, however, we emphasize that it would be subject to all of the terms and conditions of the applicable open access tariff, including the requirement that it provide reciprocal service.

Finally, we have reconsidered our NOPR position that would have limited eligibility to wholesale transmission customers. As we explained in the NOPR, the Commission's jurisdiction extends to *all* unbundled transmission in interstate commerce by public utilities. It is irrelevant to the Commission's jurisdiction whether the customer receiving the unbundled transmission service in interstate commerce is a wholesale or retail customer. Thus, if a public utility voluntarily offers unbundled retail access in interstate commerce or a state retail access program results in

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[288] In making this determination, we are not deciding whether these entities are eligible under section 211(a) of the FPA.

unbundled retail access in interstate commerce by a public utility, the affected retail customer *must* obtain its unbundled transmission service under a non-discriminatory transmission tariff on file with the Commission. Though the Commission may approve a separate retail transmission tariff when some variation is necessary or appropriate to meet local concerns,[289] we generally see no reason why retail transmission tariffs necessarily must be different from wholesale transmission tariffs. For that reason, we anticipate that in many circumstances the same open access tariff that serves wholesale customers will be equally appropriate for retail transmission customers. Therefore, unless the Commission has specifically permitted a separate retail tariff, eligible customers under the Final Rule pro forma tariff must include unbundled retail customers.[290] We discuss this further in Section IV.I.

While the rates, terms, and conditions of all unbundled transmission service will be subject to a Commission-authorized tariff, we will, in appropriate circumstances, give deference to state recommendations regarding rates, terms, and conditions for retail transmission service or regarding the proper transmission cost allocation to be used between retail and wholesale customers when state recommendations are consistent with our open access policies. This is also discussed further in Section IV.I.

Moreover, we are mindful of the fact that we are precluded under section 212(h) from ordering or conditioning an order on a requirement to provide wheeling directly to an

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289 *See* Section IV.I.

290 The Commission has no authority to order retail transmission directly to an ultimate consumer or to order "sham" wholesale transmission. *See* FPA section 212(h). However, if such access occurs voluntarily or as a result of a state program, the rates, terms, and conditions of the access are within our exclusive jurisdiction if the service is provided by a public utility.

ultimate consumer or sham wholesale wheeling. We therefore clarify that our decision to eliminate the wholesale customer eligibility requirement does not constitute a *requirement* that a utility provide retail transmission service. Rather, we make clear that if a utility chooses, or a state lawfully requires, unbundled retail transmission service,

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such service should occur under this tariff unless we specifically approve other terms.

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8. Consequences of Functional Unbundling

a. Distribution Function

The NOPR proposed functional unbundling of wholesale generation and wholesale transmission so that the public utility as a wholesale seller could not gain an undue advantage from its transmission ownership. We did not propose to further unbundle the retail transmission and distribution functions from the wholesale transmission function.

Comments

A number of commenters assert that utilities should be required to unbundle—either functionally or corporately—the distribution function from the transmission function. ELCON argues that unbundling distribution would help delineate state and Federal jurisdiction, facilitate the establishment of transmission pricing, avoid cross-subsidization, and prepare for the customer choice (retail wheeling) programs that will be implemented by states in the

future. It contends that functional distinctions between wholesale and retail service should be minimized.[331]

Other commenters, however, oppose establishing a separate distribution function. DOD asserts that the Commission can address any problems that arise by enforcing the terms of open access tariffs and that the Commission should not intrude into state ratemaking.[332]

Various state commissions question the workability and desirability of a functional test to determine the dividing line between retail transmission and local distribution.[333] CA Com recommends that, to avoid jurisdictional uncertainty surrounding functional unbundling, the Commission adopt a functional test for local distribution. Under this test, vertically integrated utilities that chose to unbundle

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into separate operating companies, including a local distribution company that sells only at retail, could establish a workable bright line between state and Federal authority without engaging in the arduous task of differentiating transmission from distribution.

Certain IOUs echo the jurisdictional concerns raised by the state commissions.[334] They believe that the unbundling of the distribution function would create significant jurisdictional problems. Pacificorp also argues that unbundling of the distribution function would create

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331 *See also* Environmental Action, Missouri Basin MPA, Texaco, EGA, AEC & SMEPA.

332 *See also* TDU Systems, Public Service Co. of CO.

333 E.g. NARUC, AZ Com, CT DPUC, OK Com, FL Com, NC Com, NM Com.

334 *E.g.*, Com Ed, Citizens Utilities, PacifiCorp.

significant jurisdictional conflict with respect to cost allocation.

Commission Conclusion

We conclude that the additional step of functionally unbundling the distribution function from the transmission function is not necessary at this time to ensure non-discriminatory open access transmission. Our approach to assuring such open access has two broad requirements: (1) functional unbundling of transmission and generation (which includes separately stated rates for generation, transmission, and ancillary services, and a requirement that a transmission provider take service under its own tariff), except for bundled retail service and (2) an OASIS with standards of conduct. We believe that additional requirements are not needed now. We further address in Section IV.I the concerns raised regarding our proposed tests to distinguish transmission and local distribution.

b. Retail Transmission Service

Comments

The majority of commenters addressing this issue believe that unbundling retail service is unnecessary to establish a competitive market and to achieve non-discriminatory open access transmission.[335] For example, PSNM argues that the Commission is not as well situated as are state regulators to oversee and supervise local reliability issues for retail customers. Central Illinois Public Service argues that due to the nature of transmission facilities and operations, it is not possible for the transmission provider to discriminate between the provision of wholesale and retail firm service. Several IOUs further contend that because the Commission is specifically precluded from mandating retail

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[335] *E.g.* Allegheny Power, PacifiCorp, MidAmerican, PECO, Public Service Co. of CO, Com Ed, NARUC, NRRI, MN DPS, ND Com, FL Com.

wheeling and has no authority over bundled retail service, the Commission cannot require retail service to be provided.[336]

In contrast, some commenters argue that functional unbundling must apply to all transmission service in interstate commerce provided by public utilities, including the transmission component of bundled retail sales.[337] They believe that this is necessary to achieve comparability. For example, CCEM asserts that if the distribution function is not unbundled, the result will be service under two separate arrangements—an explicit wholesale transmission tariff filed at the Commission and an implicit retail transmission tariff governed by a state regulatory body. According to CCEM, failure to unbundle retail transmission will allow transmitting utilities to manipulate how they characterize and account for their own uses of transmission. ABATE contends that the Commission, for efficiency reasons, should encourage states to permit retail access. It asserts that the Commission must adopt a policy that signals to states how rates, terms, and conditions of retail service will be established; once a state sets such parameters, the Commission should review them.

Commission Conclusion

Although the unbundling of retail transmission and generation, as well as wholesale transmission and generation, would be helpful in achieving comparability, we do not believe it is necessary. In addition, it raises numerous difficult jurisdictional issues that we believe are more appropriately considered when the Commission reviews unbundled retail transmission tariffs that may come before us in the context of a state retail wheeling program. The Commission therefore reaffirms its decision to require the unbundling

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336 [336] *E.g.*, Allegheny Power.

337 *E.g.*, CCEM, ABATE.

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only of wholesale transmission from generation.[338]

c. Transmission Provider

1. Taking Service Under the Tariff

In the NOPR, we explained that a public utility must take transmission services for all of its new wholesale sales and purchases of energy under the same tariff of general applicability under which others take service.[339]

Comments

A number of commenters argue that utilities should be required to take all of the transmission for their own use under their tariff.[340] CCEM asserts that a transmission owner should have to schedule, at arm's length, its retail transmission uses and pay posted rates into a separate account; otherwise the capacity might be overforecast at no cost.

PECO requests that the Commission clarify that the requirement that a transmission provider take service under its own transmission tariffs does not apply to: (1) Retail service, (2) existing wholesale contracts, and (3) pooling arrangements. UNITIL claims that the requirement for a transmission provider to take service under its own tariff and to post its own tariff rate should not apply to pool transactions where a single pool-wide rate is applied.

A number of IOUs contend that it is not necessary for the transmission provider to take service under the network tariff because both the transmission provider and the network

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338 *But see* discussion of buy/sell transactions in Section IV.I.

339 FERC Statutes and Regulations ¶32,514, at p. 33,080.

340 *E.g.*, Michigan Systems, Cleveland, Municipal Energy Agency Nebraska, Missouri Basin MPA, TAPS, Wisconsin Municipals, LG&E, NIEP, CCEM.

customers cannot use the tariff to make off-system sales. LILCO states that it is appropriate to distinguish between a transmission owner's use of its transmission system to make: (1) Wholesale bulk power sales; and (2) off-system purchases to serve its native load retail customers. LILCO contends that in the second situation it should not be required to take transmission service under its own open access tariffs.

EGA argues that transmission owners should be required to take transmission service under open access tariffs for both wholesale off-system sales and purchases. It maintains that, as retail competition increases, utilities will eventually have to take retail service under their own tariffs. Power Marketing Association believes that comparability can be achieved only if transmission service provided in connection with coordination transactions is unbundled and the transmission provider takes such transmission service under its tariff.

Consumers Power also claims that there is an inconsistency between the NOPR text, the tariffs, and the proposed regulatory language regarding whether the requirement for a utility to take service under its own tariff applies only to new wholesale transactions.

Commission Conclusion

We conclude that public utilities must take all transmission services for wholesale sales under new requirements contracts and new coordination contracts under the same tariff used by others (eligible customers).[341] For sales and purchases under existing bilateral economy energy coordination agreements, we will give an extension until

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[341] With the exception of certain contracts and agreements executed on or before 60 days after publication of the Final Rule in the *Federal Register*, the regulation we are adopting requires that public utilities take service under their open access tariff for wholesale sales or purchases of electric energy and unbundled retail sales of electric energy, effective on the date the public utility engages in such transactions.

December 31, 1996, for public utilities to take transmission service under the same tariff used by others.[342] As further discussed in Section IV.F., we will also give an extension of time to December 31, 1996, for certain existing power pooling and other multi-lateral coordination agreements to comply with this requirement. This will ensure that utilities live by their own rules for wholesale transactions and that we can achieve non-discriminatory open access transmission. In the case of a public utility buying or selling at wholesale, the

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public utility must take service under the same tariff under which other wholesale sellers and buyers take service.

2. Accounting Treatment

In the NOPR, we did not address any accounting aspects of our proposed rule.

Comments

IOUs generally object to a requirement that they pay themselves for their use of the transmission system.[343] NEPCO claims that it is a general principle of accounting that an enterprise cannot recognize and record revenues to itself. NEPCO suggests that, to ensure that utilities' financial statements are not misleading, this aspect of functional unbundling can and should be accomplished through the ratemaking process, rather than by requiring utilities to actually charge themselves revenues for taking transmission services.[344]

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342 As discussed in Section IV.F., the Commission will not impose this requirement on existing bilateral non-economy coordination agreements, but persons may file complaints that such agreements need to be modified.

343 *E.g.*, EEI, Con Ed, VEPCO.

344 *See also* NEPCO.

Atlantic City Electric states that the added costs of properly administering and accounting for these transactions separately will increase prices to ultimate consumers. It contends that ensuring that operators do not give undue preference to transactions of the transmission provider makes it unnecessary for a utility to charge itself.

CSW argues that some of the provisions of the tariffs were specifically designed for third parties and do not make sense as applied to the transmission provider (e.g., signing service agreements and running credit checks).[345]

Most IOUs suggest that a revenue credit mechanism be used to account for a transmission provider's use of its system. Florida Power Corp states that revenue credits should be equal to the utility's posted rates for transmission service multiplied by the amount of capacity reserved and/or energy transmitted by the utility.

Otter Tail proposes a revenue credit that allocates revenues based on use under the tariff of the utility's transmission investment and credits these revenues against the firm load customers' accounts.

Duke asserts that the transmission provider should maintain records reflecting transmission for its own transactions under the tariff and develop appropriate revenue credits for transmission rates. It also believes that all firm users of the transmission system should receive credits for all non-firm uses.

Allegheny Power states that the crediting of non-firm revenues to network customers would have to be done on an after-the-fact basis when their loads would be known. However, it believes that revenue crediting should occur only if the firm service customer has retained the utility to remarket the customer's unused capacity.

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345 *See also* Florida Power Corp.

Cajun proposes that all transmission revenues in excess of those implicitly included in the development of the transmission rates, including those that the utility has charged itself, be credited back to the network service transmission customers on a load ratio share basis. If transmission service rates are formula rates that are recalculated annually, Cajun proposes that excess transmission revenues be used to offset the recalculated revenue requirement. If the rates are not formula rates, Cajun states that an explicit tracker with monthly crediting to the network customer must be used.

To avoid cross-subsidization between affiliates and third parties, NRECA suggests that transmission revenues "paid" by a utility's generation function to its transmission function be credited back to the utility's nonaffiliated customers, and that any rate discounts extended to the generation function by the transmission function be filed with the Commission with a full explanation of why the discount was extended together with a showing that the discount was made available to all other similarly situated customers.

APPA contends that the Commission's current system of revenue crediting could give transmission owners an unfair competitive advantage by allowing them to use the revenue credit to subsidize the price at which they sell power. It argues that transmission owners should pay the actual price of transmission rather than booking a revenue credit as an offset to the cost of transmission service.

TAPS and Wisconsin Municipals argue that an essential element of true comparability

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is the ongoing pass-through to network customers of a load ratio share of transmission revenues generated by third-party and the transmission provider's off-system uses of the transmission system.

Houston L&P suggests that the revenue crediting mechanism proposed in the NOPR could be established to recognize the utility's transmission service revenue and expenses in non-third-party wheeling transactions by reclassifying a portion of its revenue equal to the cost of transmission services provided to itself during such transactions. This mechanism would not reclassify expense accounts, but would distinguish that transmission portion of the total transaction's revenue that was associated with covering the cost of transmission service, using the rates charged in similar third-party transactions.

PacifiCorp contends that the Commission should enforce the requirement that utilities account for revenues they pay themselves through the commission's audit powers and through complaint proceedings. It specifically recommends that each transmitting utility be required to indicate, in its Form No. 1 under Account 456, the megawatts and revenues associated with its firm and non-firm off-system sales.[346]

MT Com states that the embedded costs that the Commission functionalizes for jurisdictional purposes should be carefully reconciled with plant balances used to calculate other costs of service.

CCEM wants each transmission provider to charge and book revenues into separate accounts for (1) service provided to itself and off-system sales and third-party sales under the tariffs, (2) impact study costs that the provider performs for itself or an affiliate, and (3) ancillary service revenues, net of out-of-pocket expenses the transmission owner provides itself or an affiliate.

Arizona Public Service recommends that any revenue crediting or booking be prospective only and that

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[346] If the utility is not required to file a Form No. 1, PacifiCorp states that it should be required to file similar information annually.

enforcement occur through the Commission's periodic audits and a utility's rate cases.

Many IOUs argue that there should be no obligation to credit non-firm transmission revenues to customers who are not using their firm capacity.[347] PacifiCorp contends that all non-firm revenues should be credited against total annual revenue requirements, resulting in lower rates to all customers. Wisconsin P&L maintains that non-firm sales revenue should be shared with all network customers.

Otter Tail argues that non-firm transactions between existing utilities to support and achieve real-time system optimization should be permitted without charge to the transmission owner. CSW asserts that no credits should be made for the non-firm secondary service under the point-to-point tariff and that off-system purchases for native load should not result in a revenue credit.

Southwestern suggests that the Commission not require the crediting of a transmission component associated with off-system purchases by the public utility. Southwestern argues that a credit would interfere with a utility's ability to buy the most economic energy for its native load customers. It also argues that requiring a credit is not comparable to what network customers pay. NEPCO points out that crediting transmission associated with purchases would require native load customers to pay the costs of the utility's purchasing off-system power while network customers do not have to pay a separate point-to-point charge for their off-system purchases. Southwestern claims that the crediting requirement would double-charge the transmitting utility and its native load customers because a utility's off-system purchases directly relate to the load it serves, and that load already is reflected in the transmission rate calculation.

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[347] *E.g.*, Consumers Power, Northern States Power, PacifiCorp, Allegheny Power.

Southwestern also claims that it is unclear from the NOPR whether the Commission considers sales from the renewal of existing wholesale requirements contracts as being subject to crediting. It argues that transmission related to these sales should not be subject to the crediting requirement because this is service to native load customers.

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Brazos opposes imputing revenues associated with a utility's own use of its transmission system because this will artificially increase the cost of power and deny consumers the benefits of economy energy sales made at market-based prices.

Commission Conclusion

While we used the word "accounting" in the NOPR, the real issue is assuring that utilities bear the costs associated with their own uses of the system in a manner comparable to how they charge others. Accordingly, this is a rate issue, not an accounting issue. However, we direct utilities to account for all uses of the transmission system and to demonstrate that all customers (including the transmission provider's native load) bear the cost responsibility associated with their respective uses.[348]

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b. Services That May Be Offered and Sold as a Package

The NOPR indicated that ancillary services must be offered separately from one another but did not indicate if the transmission provider may also offer a package of ancillary services.

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348 Additional guidance on this subject is in Section IV.G.4.g.(2)(a).

Comments

Several commenters support giving customers the option either to purchase ancillary services as separate and distinct services or to purchase a package of services from the transmission provider.[394] Others, such as Tallahassee, recommend that utilities be prohibited from bundling the purchase of one service with another so that a transmission customer cannot

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rely on the transmission provider for just one or a few of the ancillary services.

EEI and ELCON argue that the Commission should permit customers the option to request that transmission providers offer packages of selected ancillary services.[395] They and other commenters express a concern that efficiencies can be lost under a policy that precludes combining ancillary services.

Commission Conclusion

We conclude that a transmission provider must offer and price the individual ancillary services separately. It may not tie the purchase of one to the purchase of another.

However, we will allow a transmission provider to assemble packages of ancillary services (not bundled with basic transmission service) that can be offered at rates that are less than the total of individual charges for the services if purchased separately. It may also offer rate discounts on any ancillary service. If a rate discount is offered to the transmission owner itself or to an affiliate of the transmission owner, the same discount must be offered to non-affiliates, as well. In addition, discounts offered to non-affiliates must be

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394 *E.g.*, Direct Service Industries, Mt. Hope Hydro, ELCON, Pa. Com.

395 EEI Initial Comments at V-4, ELCON Initial Comments at p. 21.

on a basis that is not unduly discriminatory. All discounts must be posted on the transmission provider's OASIS.

4. Reassignment of Ancillary Services

In the NOPR, the Commission noted that ancillary services may not be suitable for reassignment and requested comments on this issue.

Comments

Commenters express divided views on the reassignment issue. Some IOU commenters believe that, subject to technical limitations, ancillary services could be reassigned.[396] Other commenters, including many IOUs, oppose reassignment because they believe it is impractical.[397] In particular, PacifiCorp claims that the customer-specific nature of generation-related ancillary services prevents such services from being reassigned.

TDU Systems argue that transmission customers that must pay for ancillary services they do not need should be able to resell them to someone else.[398] Mt. Hope Hydro claims that, if a bulk power transaction and the associated transmission service can be reassigned, it is reasonable that the ancillary services used to support the transaction also should be reassigned, particularly if the same facilities and contract path are used.[399]

Commission Conclusion

We conclude that transmission customers will be allowed to reassign ancillary services along with the reassignment of basic transmission service. The Commission believes that a policy of transmission capacity reassignment

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396 *E.g.*, WP&L, NYSEG.

397 *E.g.*, Consumers, PacifiCorp, Carolina P&L, PSNM, Salt River, PA Com, TDU Systems.

398 TDU Systems Initial Comments at p. 87.

399 Mt. Hope Hydro Initial Comments at p. 17.

may not be possible unless the ancillary services used to support the transmission are also reassignable.

5. Pricing of Ancillary Services

In the NOPR, we asked for comments on ancillary service pricing and proposed specific ancillary services prices in the Stage One implementation rates. Many commenters commented on the Stage One rates. There is no Stage One in the Final Rule.

Comments

Many commenters state that ancillary services are difficult to price. They suggest diverse pricing approaches. IN Com notes that, because utilities and regulatory commissions have no experience with pricing unbundled ancillary services, the process needs to evolve but the goal should be to encourage market pricing in competitive markets. Air Liquide believes the best pricing policy should be negotiated bilateral agreements, provided market power is mitigated.

Other commenters express concern about how pricing proposed in the NOPR would affect the development and operation of competitive ancillary services markets. Industrial Energy Applications

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notes that low price caps on generation-related services, such as supplying losses, imbalance energy, operating reserve and backup power, which can be provided from many sources, inhibit competitive market development. There is little incentive for other providers to invest in facilities to provide these services. Dayton P&L and others contend that the Commission should not require transmission providers to provide generation-based ancillary services at cost-based rates and then allow third parties to resell such services at market-based rates. PacifiCorp expresses concern that the NOPR's pricing proposal would be overly restrictive in the

emerging competitive market for generation-related ancillary services.

Many commenters argue that cost-based price caps are appropriate for ancillary services if there are no alternative suppliers or until competitive markets develop.[400] AMU suggests that the comparability standard is not met if market rates exceed the costs of providing ancillary services. Allegheny, Ohio Edison and Atlantic City support cost-based pricing for Reactive Power/Voltage Control. Ohio Edison recommends cost-based pricing for frequency regulation, and Atlantic City recommends it for scheduling and dispatch.

Several commenters suggest that the Commission require cost-based rates for ancillary services where no source other than the transmission provider exists and market-based rates for generation-related ancillary services if competition exists.[401] Washington and Oregon Energy Offices recommend that, before permitting market-based rates, at least two other non-affiliated parties should be able to offer a nearly identical ancillary service and that the Commission should use the same standards for allowing market-based rates for ancillary services that it has used for wholesale power sales. Mt. Hope Hydro argues that vertically integrated utilities should be permitted to charge cost-based rates that are limited to no more than the market price for ancillary services. It also contends that companies whose generation facilities are not supported by captive retail or transmission customers should be authorized to sell at market-based prices.

The vast majority of commenters from all interest groups who address market-based pricing for ancillary services agree that market-based pricing is appropriate for ancillary

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400 *E.g.*, Utilities For Improved Transition, Idaho, CINergy, Direct Service Industries, Mt. Hope Hydro, ABATE, TDU Systems, Missouri-Kansas Industrials, Washington and Oregon Energy Offices, IN Com.

401 E.g., PJM, Texas Utilities, Entergy, Carolina P&L.

services where competitive market conditions exist. However, commenters disagree over whether a competitive market for ancillary services currently exists.

In determining the extent of competition, many commenters distinguish between ancillary services that are (1) generation-related and (2) transmission-related. Commenters disagree over whether the Commission can declare generation-related ancillary services to be competitive on a generic basis. Many commenters contend that transmission-related ancillary services are not available in a competitive market; consequently, they agree that prices for such services should be cost-based.

Commission Conclusion

We will consider ancillary services rate proposals on a case-by-case basis.

In response to comments,[402] we offer here some general guidance on ancillary services pricing principles.

(1) Ancillary service rates should be unbundled from the transmission provider's rates for basic transmission service, even though such services are a necessary adjunct to basic transmission service.

(2) The fact that we have authorized a utility to sell wholesale power at market-based rates does not mean we have authorized the utility to sell ancillary services at market-based rates.

(3) In the absence of a demonstration that the seller does not have market power in such services, rates for ancillary services should be cost-based and established as price caps, from which transmission providers may offer a discount to

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[402] Many commenters were particularly concerned that rates for energy losses, a NOPR ancillary service, should be market-based. We need not address this concern in this Rule, however, because we will not require Real Power Losses to be offered as an ancillary service.

reflect cost variations or to match rates available from any third party. If a rate

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discount is offered to the transmission owner itself or to an affiliate of the transmission owner, the same discounted rate must be offered to non-affiliates, as well. In addition, discounts offered to non-affiliates must be on a basis that is not unduly discriminatory. All discounts must be posted on the transmission provider's OASIS.

(4) The amount of each ancillary service that the customer must purchase, self-supply, or otherwise procure must be readily determined from the transmission provider's tariff and comparable to the obligations to which the transmission provider itself is subject. The provider must take ancillary services for its own wholesale transmission under its own tariff.

(5) The location and characteristics of a customer's loads and generation resources may affect significantly the level of ancillary service costs incurred by the transmission provider. Ancillary service rates and billing units should reflect these customer characteristics to the extent practicable.

6. Accounting for Ancillary Services

Comments

Some commenters suggest that there may be a need for revising the Uniform System of Accounts to track better the costs of providing discrete ancillary services. Other commenters believe that ancillary services are transmission-type services and suggested that the costs of generation-provided ancillary services be refunctionalized from power production expense to transmission expense.

Oak Ridge asserts that a primary goal of those interested in restructuring the electricity industry should be to identify clearly the different functions that are today buried within the vertically integrated utility and bundled into one price. Oak

Ridge, however, indicates that achieving this ideal of identifying unbundled services at appropriate prices will be difficult because of utility accounting practices.

EEI asserts that since the current Uniform System of Accounts was designed to track costs incurred to provide bundled wholesale service, it does not track the discrete costs incurred to provide ancillary services. Therefore, according to EEI, a major update is needed to support the pricing of discrete ancillary services.

ConEd states that ancillary services are integral and essential elements of providing transmission services. It notes that, historically, due to the vertical integration of utilities, those services have been bundled with the other services provided and the costs associated with providing ancillary services have not been specifically defined. ConEd claims that to a large degree, this is due to the fact that utility accounting mechanisms were not established with the intention of identifying the costs for ancillary services.

UI asserts that if transmission customers are to be charged for certain ancillary services, it may be necessary to refunctionalize certain specific costs items from generation to transmission. UI points out that some of the reactive power to support system voltages and to provide transmission services, for example, is supplied from the variable reactive output of the generators. It states that these costs, to the extent they can be identified with the provision of transmission service, should be refunctionalized to the transmission account. However, UI states it may not be possible to develop a unit cost for specific transactions. Thus, UI states it may be more appropriate to roll these costs into the embedded transmission rate and allocate them among the various users of the transmission system.

Commission Conclusion

To ensure comparable transmission access a Transmission Provider is obligated to offer or arrange to

provide certain ancillary services to the Transmission Customer. Also, the Transmission Provider may offer to provide other ancillary services to the Transmission Customer. A Transmission Customer is obligated to purchase certain ancillary services from the Transmission Provider.

Generation resources provide certain ancillary services, while transmission resources provide other ancillary services. Consequently, the costs of providing certain ancillary services are recorded in the utility's power production expense accounts, while others are recorded in the utility's transmission expense accounts.

Currently, the Uniform System of Accounts requires that costs incurred in providing ancillary services be recorded as power production or transmission expense depending upon which resource the utility uses to supply the service. At this time,

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we are not convinced that the amounts involved or the difficulty associated with measuring the cost of ancillary services warrants a departure from our present accounting requirements. We will specify, however, that revenues a Transmission Provider receives from providing ancillary services must be recorded by type of service in Account 447, Sales for Resale, or Account 456, Other Electric Revenues, as appropriate.

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4. Bilateral Coordination Arrangements

Any bilateral wholesale coordination agreement executed after the effective date of this Rule will be subject to the functional unbundling and open access requirements set forth in this Rule. With regard to existing bilateral

agreements, however, the diversity of the types of agreements currently on file presents special implementation problems. The Commission is particularly concerned with future economy energy transactions that may occur pursuant to existing umbrella-type

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coordination agreements. Accordingly, we shall require all bilateral economy energy coordination contracts executed before the effective date of this Rule to be modified to require unbundling of any economy energy transaction occurring after December 31, 1996. All non-economy energy bilateral coordination contracts executed before the effective date of this Rule will be permitted to continue in effect, but will be subject to complaints filed under section 206 of the FPA. Under those procedures, the rates, terms, and conditions of individual coordination contracts may be challenged as unduly discriminatory or otherwise unlawful.

To compute the unbundled coordination compliance rate, the utility must subtract the corresponding transmission unit charge in its open access tariff from the existing coordination rate ceiling. For example, if a utility has a coordination rate ceiling for hourly service of incremental cost plus 15 mills/kWh and a transmission tariff rate for hourly service of 3 mills/kWh, it shall revise the coordination rate ceiling to incremental cost plus 12 mills/kWh. The Commission cautions that the compliance filing will be strictly limited to removing the current transmission tariff price from the coordination price and will not be a medium for otherwise revising the residual coordination sales price.

The transmission rate for the coordination transactions may be at or below the tariff rate. However, if a utility's transmission operator offers a discounted transmission rate to the utility's wholesale marketing department or an affiliate for the purposes of coordination transactions, the same discounted rate must be offered to others for trades with any

party to the coordination agreement. In addition, discounts offered to non-affiliates must be on a basis that is not unduly discriminatory.[424] This may require parties to file modifications of the coordination arrangements.

ISO Principles

The Commission recognizes that some utilities are exploring the concept of an Independent System Operator and that the tight power pools are considering restructuring proposals that involve an ISO. While the Commission is not requiring any utility to form an ISO at this time, we wish to encourage the formation of properly-structured ISOs. To this end, we believe it is important to give the industry some guidance on ISOs at this time. Accordingly, we here set out certain principles that will be used in assessing ISO proposals that may be submitted to the Commission in the future.

These principles are applicable only to ISOs that would be control area operators, including any ISO established in the restructuring of power pools. We recognize that some utilities are exploring concepts that do not involve full operational control of the grid. Without in any way prejudging the merits of such arrangements, the following principles do not apply to independent administrators or coordinators that lack operational control. We do not have enough information at this time to offer guidance about such entities, but recognize that they could perform a useful role in a restructured industry.

Because an ISO will be a public utility subject to our jurisdiction,[425] the ISO's operating standards and procedures must be approved by the Commission. In addition, a properly

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[424] All discounts must be posted on the transmission provider's OASIS.

[425] A public utility is any person that owns or operates facilities used for the transmission of electric energy in interstate commerce or the sale of electric energy at wholesale in interstate commerce. An ISO will operate facilities used for the transmission of electric energy in interstate commerce and thus will be subject to the Open Access and OASIS rules.

constituted ISO is a means by which public utilities can comply with the Commission's non-discriminatory transmission tariff requirements. The principles for ISOs are:

1. The ISO's governance should be structured in a fair and non-discriminatory manner. The primary purpose of an ISO is to ensure fair and non-discriminatory access to transmission services and ancillary services for all users of the system. As such, an ISO should be independent of any individual market participant or any one class of participants (e.g., transmission owners or end-users). A governance structure that includes fair representation

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of all types of users of the system would help ensure that the ISO formulates policies, operates the system, and resolves disputes in a fair and non-discriminatory manner. The ISO's rules of governance, however, should prevent control, and appearance of control, of decision-making by any class of participants.

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G. Pro Forma Tariff

In the NOPR, the Commission stated that—

> all utilities use their own systems in two basic ways: to provide themselves point-to-point transmission service that supports coordination sales, and to provide themselves network transmission service that supports the economic dispatch of their own generation units and purchased power resources (integrating their resources to meet their internal loads).[426]

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426 *FERC Statutes and Regulations* ¶32,514, at p. 33,079.

Accordingly, the Commission proposed two pro forma tariffs in Appendices B and C of the NOPR: One for point-to-point service and one for network service. Our goal was to encourage the development of competitive bulk power markets by ensuring that all participants would be able to secure transmission services on a non-discriminatory basis. We attempted in the NOPR pro forma tariffs to articulate the minimally acceptable terms and conditions of service for point-to-point and network transmission service that were required to ensure non-discriminatory transmission service.[427] We explained that, for the most part, specific pricing provisions were omitted. We asked for

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comments on whether these tariffs provided a good basis for defining the minimum acceptable non-price terms and conditions of service.[428]

Subsequently, in a June 28, 1995 order, we encouraged public utilities to file open access transmission tariffs as soon as possible.[429] Tariffs with terms and conditions of service substantively similar to the NOPR pro forma tariffs would become effective without a refund condition, assuming there were no other concerns, *e.g.*, rate issues. We also indicated that these tariffs would be subject to revision based on the Final Rule.

Unified Pro Forma Tariff

The Commission received many comments on both the point-to-point and network tariffs. Many commenters suggested improvements to the proposed tariffs. Others took

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427 *Id.* at p. 33,092.

428 On October 27, 1995, the Commission's staff sponsored a technical conference on the pro forma tariffs.

429 American Electric Power Service Corporation, et al., 71 FERC ¶61,393, modified, 72 FERC ¶61,287 (1995).

issue with how to reconcile various aspects of service under the two tariffs (e.g., cost allocation, service priority, customer rights and obligations). As discussed below, the Commission has attempted to address these concerns in developing tariff requirements for the Final Rule. Importantly, while the Commission has retained point-to-point transmission service and network transmission service as distinct services, the requirements for the two services are now in a single pro forma tariff.[430] The Final Rule pro forma tariff eliminates many of the differences between the two NOPR pro forma tariffs, provides a unified set of definitions, and consolidates certain common requirements such as the obligation to provide ancillary services. The general terms and conditions of transmission service specified in the Final Rule pro forma tariff should be familiar to all utilities, particularly those that have voluntarily filed open access tariffs based on the NOPR pro forma tariffs.

The Commission believes that the modified, single pro forma tariff, in conjunction with the other requirements, is sufficient to remedy undue discrimination in the provision of transmission services. However, we note that in an accompanying notice of proposed rulemaking in Docket No. RM96-11-000, we are seeking comments on whether a different form of open access tariff—one based solely on a capacity reservation system—might better accommodate competitive changes occurring in the industry while ensuring that all wholesale transmission service is provided in a fair and non-discriminatory manner.

We address below the comments received on the NOPR tariff and the specific modifications we have made in the Final Rule pro forma tariff.

1. Tariff Provisions That Affect The Pricing Mechanism

a. Non-Price Terms and Conditions

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[430] The Final Rule pro forma tariff is attached as Appendix D.

Comments

Utilities For Improved Transition argues that any generic imposition of detailed tariffs on the electric industry will stifle the evolution of the industry. Rather, it asserts, utilities that supply transmission service should be permitted to apply general principles of comparability in their company-specific tariffs, using terms and conditions of service based on their own particular circumstances and those of their customers.

Utility Working Group wants the final rule to allow utilities to depart from the pricing method implicitly contained in the NOPR pro forma tariffs. It argues that the final rule should recognize that some terms and conditions may not make sense in the context of innovative pricing proposals.

DOE thinks that it is proper to base the tariffs on a familiar and simple pricing method. However, DOE suggests that, in the future, the Commission carefully assess the workability of the contract path model in a competitive bulk power market. DOE suggests that spot or real-time pricing should be considered.

Numerous commenters contend that the NOPR pro forma tariffs are based upon the contract path, embedded cost methodology. According to EEI and other IOU commenters, conforming changes may be needed to various terms and conditions

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of the tariffs to implement pricing methodologies that are not based upon contract path. These commenters argue that any flow-based model would necessitate different non-price terms and conditions. The commenters generally recognize the technical difficulties of implementing a flow-based

model.[431] These commenters assert that the NOPR pro forma tariffs, as written, are not independent of pricing.

EGA criticizes the assumption underlying the contract path approach, i.e., that the capacities of individual transmission paths can be determined independently and made available to third parties. EGA notes that, in light of the competitive implications associated with transmission pricing, some utilities may propose other non-price terms and conditions suitable for other pricing methods, including power-flow-based tariffs. EGA expresses concern that the pro forma tariffs will be the only type of tariff allowed. EGA believes that the Commission should follow its transmission pricing policy guidelines and not impose a special burden on parties proposing tariffs that differ from the final rule pro forma tariffs, including non-price terms that support alternative pricing methods.

Some commenters also interpret the lack of reference to opportunity cost and incremental cost in the NOPR pro forma tariffs as a rejection of their use.[432]

Commission Conclusion

We agree that non-price terms and conditions cannot be designed independent of pricing and cost recovery. As discussed in detail below, the Final Rule pro forma tariff is intended to *initiate* open access, with non-price terms and conditions based on the contract path model of power flows and embedded cost ratemaking. It is designed based on the practices and procedures currently used by virtually all public utilities and complements the large number of tariffs already filed with the Commission. The Final Rule pro forma tariff is not intended to signal a preference for contract path/embedded cost pricing for the future. We recognize that

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[431] Additional comments concerning transition to flow-based pricing are summarized in Section IV.A.6.

[432] *E.g.*, BPA, Utilities For Improved Transition, PG&E, Duke.

the industry, in response to changes in institutions, competitive pressure, and technological innovations, is evolving rapidly. For example, various forms of flow-based pricing are beginning to be considered in conjunction with electronic transmission information systems. We seek to encourage this process and will in the future entertain non-discriminatory tariff innovations to accommodate new pricing proposals.[433]

In response to various comments, we are revising certain non-price terms and conditions where suggested changes either improve the tariff services or reconcile tariff inconsistencies. The nature of these tariff revisions does not appear to have serious cost consequences. The mandated changes are generally compatible with the rate proposals already filed by many public utilities. As discussed in Section IV.H., those utilities will not be required to file corresponding rate changes due to our mandated tariff changes to non-price terms and conditions, although they will be permitted to do so.

The Final Rule pro forma tariff includes specific terms and conditions rather than general principles. By initially requiring a standardized tariff,[434] we intend to foster broad access across multiple systems under standardized terms and conditions. However, in response to concerns raised by certain commenters, the tariff provides for certain deviations where it can be demonstrated that unique practices in a geographic region require modifications to the Final Rule pro forma tariff provisions. Accordingly, where applicable, the tariff permits the use of alternative non-price terms or

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[433] We further clarify that, contrary to some commenters' interpretation, the Final Rule pro forma tariff is in no way a rejection of opportunity or incremental cost pricing.

[434] As noted in Section IV.H., public utilities may propose variations that are consistent with or superior to the terms and conditions in the Final Rule pro forma tariff.

conditions that are reasonable, generally accepted in the region, and consistently adhered to by the transmission provider.

Finally, we will allow utilities to propose a single cost allocation method for network and point-to-point transmission services. These principles, as well as other

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modifications and clarifications to the NOPR pro forma tariffs, are discussed in detail below.

b. Load Ratio Sharing Allocation Mechanism for Network Service

Comments

Some commenters believe that load ratio cost allocation is appropriate for network service.[435] Other commenters argue that load ratio cost allocation is inappropriate, but disagree on the alternative. They offer a variety of other cost allocation and pricing methods.

The most frequent comment is that network and point-to-point services should be priced on the same basis. Florida Power Corp wants network contract demand to be offered and priced on a 12 CP basis.[436] ConEd and Duke argue that their systems are built and designed to meet a single peak; therefore, they contend that network service costs should be allocated with a load ratio calculation based on annual system peak rather than 12 CP. PSE&G claims that load ratio cost allocation works only if the customer has its own generation. Many commenters propose that "behind the

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435 *E.g.*, PSNM, WP&L.

436 Florida Power Corp's contract demand proposal would allow a network customer to nominate less than its full load for transmission service.

meter" generation and load be eliminated from the network load ratio calculation.[437]

CINergy notes that the transmission provider's monthly load ratio calculation includes its long-term off-system firm service. It proposes that off-system sales be eliminated from the load ratio calculation to enable the transmission provider to offer discounts on long-term service. Alternatively, CINergy proposes that the revenues from these long-term off-system sales be shared with network customers based on their load ratio.

Atlantic City and Allegheny contend that cost allocation for network service should also reflect customers' relative energy use (*i.e.*, not just customers' coincident demand). Consequently, these commenters propose that cost allocation consider the network customer's actual load factor. Allegheny also proposes adding a minimum revenue provision to the load ratio method to recognize cost responsibility for non-peak use. Allegheny further proposes to include an increasing return on equity as available transmission capacity decreases. EEI proposes that cost allocation be based on a customer's non-coincident peak demand.

Lower Colorado River Authority proposes using load flow studies to determine planned use during the system peak with MW-mile billing units. It believes that this pricing method should be used for all transmission service to ensure comparable transmission pricing. Oklahoma G&E wants cost allocation to be based on the impacted MW-mile method, or alternatively, to determine embedded cost by voltage level. Centerior proposes the use of actual transfer capability instead of contract path capability in determining cost responsibility.

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[437] *E.g.*, Cajun, NRECA.

Orange & Rockland recommends some form of a "poolco" approach using locational marginal cost pricing. DOE also recommends using location-specific spot pricing (a form of marginal cost) for operating and congestion costs.

Public Generating Pool believes that load ratio share pricing is unworkable in the Pacific Northwest, in part because generation is generally located outside of the control area directly served by parties in the Northwest, and in part because BPA, which does not have a typical service territory, dominates the regional transmission market. Seattle states that cost allocation based solely on demand is inappropriate for systems that consist predominantly of hydro generation.[438]

AEC & SMEPA and NRECA are concerned about pancaked rates for network service that is provided to load served by more than one network tariff. Other commenters advocate use of some form of regional pricing.[439] American Wind proposes the use of a complex seasonal calculation, which appears to benefit wind energy. NY Com and Missouri-Kansas Industrials also express a preference for seasonal pricing models.

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g. Ceiling Rate for Non-Firm Point-to-Point Service

Comments

Commenters generally support a ceiling rate for non-firm transmission service, capped at the firm rate.[453] Others

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[438] Additional comments concerning the Pacific Northwest are summarized in Section IV.K.

[439] *E.g.*, OH Coops, Municipal Energy Agency Nebraska, UT Com.

[453] *E.g.*, Duke, SCE&G, AEP, FPL.

request clarification as to whether the point-to-point tariff rates are fixed or are ceiling rates. Central Illinois Public Service's major concern is that, if the rates are fixed, the tariffs may result in higher prices for capacity and energy than those currently allowed for bundled service.

NYSEG argues that unequal pricing is a natural phenomenon of the open marketplace and requests assurance that offering transmission service at prices below a cost-based ceiling rate will not expose a transmission provider to claims of undue discrimination.

AEC & SMEPA opposes using the firm rate as the cap for non-firm transmission service. It states that, given the substantially lower quality of non-firm service (with no obligation to plan for such service), no cost-of-service principle justifies charging rates for non-firm service as high as the rate for firm service.

EGA and NRECA state that any discounts from the maximum firm rate must be uniform, transparent, readily understood, and posted on a RIN. According to CCEM and NRECA, the transmitting utility must have nondiscriminatory discount practices and must contemporaneously offer discounts to transmission customers at the same time and on the same basis as discounts for internal sales operations or affiliates.

Commission Conclusion

We believe that it is important to continue to allow pricing flexibility. In accordance with the Commission's current policies, the rate for non-firm point-to-point transmission service may reflect opportunity costs. Any provisions for opportunity cost pricing for non-firm service must meet the requirements already discussed. If a utility chooses to adopt opportunity cost pricing, the non-firm rate is effectively capped by the availability of firm service and is not subject to a separately-stated price cap. If a utility chooses not to adopt opportunity cost pricing, the non-firm

rate is capped at the firm rate. We also wish to ensure that non-firm transmission service is priced in a nondiscriminatory fashion. Accordingly, if a transmission provider offers a rate discount to its affiliate, or if the transmission provider attributes a discounted rate to its own transactions, the same discounted rate must also be offered at the same time to non-affiliates on the same

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transmission path and on all unconstrained transmission paths. We will further require that any affiliate discounts from the maximum firm rate must be transparent, readily understandable, and posted on the transmission provider's OASIS in advance so that all eligible customers have an equal opportunity to purchase non-firm transmission at the discounted rate.[454] In addition, discounts offered to non-affiliates must be on a basis that is not unduly discriminatory and must be reported on the OASIS within 24 hours of when available transmission capability (ATC) is adjusted in response to the transaction. As discussed in the RIN section, information, including the price for all non-firm transaction discounts, must be posted on the OASIS to ensure comparability.

2. Priority For Obtaining Service

Comments

The term "priority" is used in the comments in several senses. The intent of the comment depends on which kind of "priority" is intended. In general, there are comments about

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[454] The same requirements will apply to discounts from firm transmission service. Similarly, if a transmission provider offers an affiliate a discount for ancillary services, or attributes a discounted ancillary service rate to its own transactions, it must offer at the same time the same discounted rate to all eligible customers. Discounted ancillary services rates must be posted on the OASIS pursuant to new Part 37 of the Commission's regulations.

the order in which parties can obtain new service, which we call "reservation priority," and there are comments about the order in which parties lose service they already have, which we call "curtailment priority." Commenters may establish different reservation priorities for various services, such as network, off-system sales, firm, ability to reserve a portion of new transmission capacity to be constructed, and so on. Curtailment priorities also differ with the type of service. However, many commenters assert that certain parties should or should not have "priority" without distinguishing the kind of priority or type of service for which priority is intended.

a. Reservation Priority for Existing Firm Service Customers

Comments

Many IOUs, state commissions, and cooperatives strongly believe that native load should have priority to reserve transmission capacity under the tariffs.

EEI suggests that existing and future allocations of transmission capacity must be based on proper transmission pricing or, in its absence, priority of service. According to EEI, retail and existing wholesale requirements service should have the highest priority for use of transmission capacity, followed by long-term point-to-point service. Dayton P&L supports a continued preference for native load growth because native load customers have borne the majority of the costs of the transmission system. Detroit Edison, EEI, and Florida Power Corp claim that, because native load and network customers pay higher rates during all hours, such customers should have higher priority for service requests than others requesting transmission service. These commenters also claim that the transmission provider should be able to reserve firm capacity for native load and network service customers.

Similarly, NARUC wants wholesale and retail native load customers to be held harmless from functional

unbundling of wholesale transmission services. Because these customers have borne the vast majority of the costs of the utility's transmission facilities, NARUC argues that priority of service, quality of service, and allocation of joint and common costs to native load customers should not be affected by the transition to an open access transmission regime.

PA Com does not share the Commission's concern that a transmission provider may discriminate against a third party transmission customer vis-a-vis native load. It finds nothing impermissible in this sort of discrimination, arguing that the interconnected system was financed by, designed for, and built to serve native load.

NRECA explains that most transmission customers that seek network service will already be receiving similar service (albeit in a bundled form) from their transmission providers. It argues that these customers should receive the same priority of service as the transmission provider's native load customers for as long as they continue to take network service, whether under a current bundled whole

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sale supply contract, a private transmission contract, or a network tariff.[454]

East Kentucky requests that the final rule clarify that member distribution cooperatives of G&Ts will have priority over third parties in the use of the G&T's existing transmission facilities. TVA comments that native load customers and emergency service to neighboring systems should have a higher service priority than transmission services sold to third parties (where an alternative power supply is available to the third party).

Commission Conclusion

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[454] *See also* American Forest & Paper, AMP-Ohio.

We reiterate that we are not requiring the transmission provider to unbundle transmission service to its retail native load nor are we requiring that bundled retail service be taken under the terms of the Final Rule pro forma tariff. However, the amount of transmission capacity available to wholesale and unbundled retail customers under the Final Rule pro forma tariff is clearly affected by the amount of transmission capacity that the transmission provider reserves for the use of its native load customers and the future load growth of those customers. The transmission provider may reserve in its calculation of ATC transmission capacity necessary to accommodate native load growth reasonably forecasted in its planning horizon. However, the transmission provider is obligated to provide transmission service to others under the Final Rule pro forma tariff out of capacity reserved for native load growth up to the time the capacity is actually needed for such future needs. Furthermore, as we explained previously, while existing wholesale customers do not have any ownership-like rights to the capacity they used during the term of their contract, they will have a right of first refusal to that capacity after the expiration of their contracts or when their contracts become subject to renewal or rollover.[455]

b. Reservation Priority for Firm Point-to-Point and Network Service

Comments

A number of commenters argue that all firm service should not be treated equally. These commenters argue that the price of the service should determine the priority that the service receives. A large number of IOUs and potential network customers (existing requirements customers) argue that in light of the pricing implicit in the NOPR, (*i.e.*, 12 CP for network versus annual system peak for point-to-point) network service should have priority over point-to-point

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[455] *See* discussion in Section IV.A.5.

service (because, all other things being equal, the price for network service will be higher).

BG&E believes that a customer receiving service priority equal to native load and network customers should pay comparable rates. Thus, BG&E argues that either flexible firm point-to point service should be priced the same as network service, or point-to-point service should have a lesser priority than native load and network service customers if point-to-point service is priced lower than network service.

DE Muni believes that native load and network customers must have priority access to interfaces (particularly where they are constrained) after system reliability concerns have been satisfied. The same argument is advanced by commenters concerning long-term service versus short-term service. Public Generating Pool argues that long-term service should always have priority over short-term service because long-term customers contribute more towards fixed-cost recovery than do short-term customers.

Cajun objects to having its service and service to its customers, which it characterizes as network service, receive the same priority as firm point-to-point service customers who take service for periods as short as one hour. Cajun points out that it, as well as other network and native load customers, have been paying and will be paying for the transmission facilities in place to serve their needs for many years. According to Cajun, the transient firm point-to-point customer should not have equal standing. Cajun suggests, however, that a long-term firm point-to-point customer taking service for ten years or more should have service priority equal to native load and network service customers.

SC Public Service Authority argues that the availability of short-term firm service with a priority equal to long-term service would provide a means for short-term

customers to obtain the advantages of long-term firm service at a much lower total cost. As a result, it argues that a few point-to-point customers would opt for long-term firm service, and the burden of the residual costs of the transmission system would fall on network customers.

EEI claims that priority for point-to-point service should be on a continuum of firmness, with reservation (as well as curtailment) priority based upon duration of service and specific negotiated terms. EEI proposes that the point-to-point tariff be modified to provide a first-tier category of flexible point-to-point transmission service that is comparable in priority, price, length, and terms of service to network service. EEI believes that this modification will resolve the problems that are associated with establishing priorities between network service and point-to-point service if the Commission retains different CP cost allocation methods for each service.

On the other hand, CCEM, a group of power marketers, supports the concept that all firm service should be treated equally, regardless of the term or the nature of service.

Commission Conclusion

An essential element of non-discriminatory transmission access is the right of transmission customers to reserve and purchase transmission service that is of the same quality as that used by the transmission provider in serving its wholesale requirements customers and retail load. Thus, we reject the proposal of some commenters that transmission providers need not provide firm point-to-point service that is of the same "firmness" as the transmission provider's service to native load. However, the fact that both network service and point-to-point service are provided on an equally firm basis does not mean that both types of service must be priced or reserved in the same manner.

The comments about reservation priorities for firm services boil down to two concerns. First, due to the

differences in pricing firm point-to-point service and network service implicit in the NOPR (*i.e.*, twelve-monthly CP pricing for network versus annual system peak for point-to-point), some commenters believe that network service should have priority over point-to-point service. Second, some commenters maintain that according firm, short-term point-to-point service a priority equal to long-term service provides a means for short-term customers to avoid making a fair contribution to the long-term costs of the system.

With respect to the first concern, we have eliminated the differences in pricing by permitting utilities to adopt point-to-point reservations as the customer load. As discussed above, for purposes of the Final Rule pro forma tariff, utilities are free to propose a single cost allocation method for the two services.

The second area of concern arises because of the first-come first-served reservation priority in the NOPR point-to-point tariff. The Commission recognizes that the tariffs, as proposed in the NOPR, provide the opportunity for a customer to reserve certain valuable rights (*e.g.*, the right to short-term firm service during peak periods) while avoiding in part the long-term costs of the system (perhaps by relying on non-firm service during lengthy off-peak periods when there is a substantially reduced chance of interruption). However, the Commission has a countervailing concern that the transmission provider should not be able to withhold valuable transmission capacity from potential customers if that capacity is not being used by those who are paying for the long-term costs of the system.

Accordingly, the Final Rule pro forma tariff provides a mechanism to address this concern while safeguarding the rights of potential customers to obtain access to unused capacity. The tariff provides that reservations for short-term firm point-to-point service (less than one year) will be conditional until one day before the commencement of daily service, one week before the commencement of weekly

service, and one month before the commencement of monthly service. These conditional reservations may be displaced by competing requests for longer-term firm point-to-point service. For example, a reservation for daily firm point-to-point service could be displaced by a request for weekly firm point-to-point service during an overlapping period. Before the applicable reservation deadline, a holder of a conditional firm point-to-point reservation would have the right of first refusal to match any longer-term firm point-to-point reservation before being displaced. After the deadline, the reservation becomes

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unconditional, and the service would be entitled to the same priorities as any long-term point-to-point or network firm service.[456]

The Final Rule pro forma tariff does not propose point-to-point or network service with various degrees of firmness beyond the simple categories of firm and non-firm. When a customer requests firm transmission service, reservation priorities are established based first on availability, and in the event the system is constrained, based on duration of the underlying firm service request; customers may choose the "firmness" of service they want by electing to take non-firm service, or by reserving and paying for firm service. We have not included any degrees of firmness in the Final Rule pro forma tariff because having intermediate categories of firmness under point-to-point or network service would, we believe, unnecessarily complicate the priority system. However, utilities are free to propose and fully support different reservation priority provisions for firm service in subsequent rate filings as long as those provisions are not

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[456] The service itself, as opposed to reservations, is subject to the curtailment provisions discussed below.

unduly discriminatory, fully comply with the principles of comparability, and are priced appropriately.

c. Reservation Priorities for Non-firm Service

Comments

IOUs, state commissions, and potential network customers tend to support the service reservation priorities for non-firm service set forth in the NOPR pro forma tariffs (i.e., transmission service by network customers for economy purchases to serve network load has a higher priority than non-firm point-to-point service, which has a higher priority than a firm point-to-point customer using transmission service at secondary points of receipt and delivery). However, because network customers pay a higher rate than point-to-point customers, these commenters argue that network customers should be permitted to use their off-peak load ratio share of the transmission system to make off-system sales. Many commenters argue that point-to-point customers can use their secondary service for both purchases and sales; thus, they believe it is discriminatory to limit network customers to purchases at secondary points.

Commenters that are opposed to the service reservation priority scheme in the NOPR pro forma tariffs argue that transmission providers will discriminate against third party users in favor of their native load economy purchases. These commenters argue that all non-firm service should have equal priority.

Other commenters, such as CINergy, would base priority on the duration of service. CINergy claims that this method would eliminate what it claims is an advantage (over network) given in the NOPR to point-to-point service in making short-term purchases. TVA notes that it establishes priority for non-firm service based on duration of service requested, with customers in each service category receiving priorities based on the rate they wish to pay.

Some commenters believe that the transmission price should affect the priority of customers to obtain non-firm transmission capacity.[457] However, other commenters argue that this seems to be precluded by the NOPR pro forma tariffs' service priority provisions.

Although PSE&G believes that the NOPR pro forma tariffs suggest a first-come, first-served allocation method for capacity in excess of that needed for firm transmission service, it proposes a fixed period of time for all potential users to submit bids for service (*e.g.*, one week prior for monthly service), allowing the bid price to determine priority (*i.e.*, the higher bid prices receive service priority over lower bid prices). According to PSE&G, customers could bid an "up to" rate subject to a price floor, with all revenues flowed back to firm service customers. TVA also advocates departing from the first-come, first-served approach for allocating some uses of the transmission system, claiming that price is an effective means to establish priority for non-firm and short-term firm services.

Utility Wind Interest Group requests that non-firm service used for transmitting renewable resources be given a higher priority than non-firm service used

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for transmitting conventional resources because renewable resources cannot store their fuel supply.

Commission Conclusion

We continue to believe that network economy purchases should have a reservation priority over non-firm point-to-point and secondary point-to-point uses of the transmission system. Network transmission customers are obliged to pay all of the costs of the transmission system without regard to the resources from which energy is scheduled. Therefore, it is

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457 *E.g.*, Duke, Orange & Rockland.

appropriate that the transmission associated with a network customer's economy purchases (i.e., transmission that is used to substitute one resource for another on an as-available basis) enjoys a higher priority than non-firm point-to-point transmission service.

Regarding the reservation priority for non-firm service under point-to-point service, we will adopt a reservation priority based upon duration of non-firm service, with price acting as a tie-breaker for competing service requests of an equal duration. If there is insufficient transmission capacity to accommodate all non-firm transmission requests, the reservation of longer duration should displace the shorter. For example, a reservation for a month of non-firm service will displace a reservation for a week of non-firm service. Also, a reservation for a week will displace a reservation for a day, which will displace a reservation for an hour of non-firm service. If a customer requests non-firm and later another customer requests longer-term non-firm service before either term of service begins, the first customer to request service has the right of first refusal to change its request to the longer term of service. A firm point-to-point customer's use of transmission service at secondary points of receipt and delivery will continue to have the lowest reservation priority.

3. Curtailment Provisions

a. Pro-rata Curtailment Provisions

Comments

A large number of IOUs that are control area operators argue for discretion to curtail the transaction that most effectively relieves the constraint, in lieu of mandatory pro-rata curtailments, which they argue are inappropriate and not cost effective.

Other commenters that do not support pro-rata curtailment argue that preference should be given to native

load or existing customers because these customers have paid the majority of the costs of the transmission system. A large number of customers note that their existing contracts contain "enhanced" curtailment priorities (*i.e.*, service to others will be curtailed before service to customers with such curtailment priority) due to the large capital outlays made by them in connection with their service.[458]

Public Generating Pool believes that the proposed curtailment provisions may not be flexible enough for transactions in the Northwest. It argues that hydro spill should be avoided, and suggests that transactions from federal and/or non-federal hydroelectric generation facilities should not be curtailed pro rata with other transactions that do not rely on such facilities. Public Generating Pool urges that regional agreements (*e.g.*, regional transmission group agreements) that would achieve this goal should be given deference.

Other commenters support pro-rata curtailments for firm service.[459] PSNM states that this has been its operating practice in the past, and PSNM expects to continue such an approach in the future.

Power marketer commenters generally support the pro-rata curtailment adding that a standardized curtailment priority applied nationally would provide greater open access and eliminate discriminatory curtailments.

Commenting on a related subject, EEI maintains that the network tariff provision for termination of service in the event a customer fails to curtail load[460] may not be realistic for service to a Transmission Dependent Utility. EEI suggests that the Commission supplement this provision with

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458 *E.g.*, TANC, Turlock, SMUD.

459 *E.g.*, PSNM and Nebraska Public Power District.

460 Proposed Pro Forma Network tariff section 9.7—System Reliability.

a substantial penalty provision, coupled with an indemnification requirement.

[31,749]

Commission Conclusion

It was not our intent in the NOPR to require all transactions to be curtailed on a pro-rata basis regardless of whether the transaction relieves a constraint. We intended to permit curtailments of transactions that substantially relieve a constraint.[461] We intended and continue to believe that curtailment on a pro-rata basis is appropriate for curtailing the transactions that substantially relieve the constraint. In order to allay the concerns of the commenters addressing this issue, we are clarifying the curtailment provision of the tariff to explicitly allow the transmission provider discretion to curtail the services, whether firm or non-firm, that substantially relieve the constraint. Of course, any curtailment must be made on a non-discriminatory basis, including curtailment of the transmission provider's own use of the transmission system. Customers that believe the curtailment policy is administered unfairly may file a section 206 complaint at the Commission.

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[461] The Final Rule pro forma tariff contains language allowing the transmission provider the discretion to interrupt firm transmission service in an emergency or other unforeseen condition in a manner suggested by these commenters. Section 11.6, Curtailment of Firm Service, of the Final Rule pro forma tariff provides:

> However, the Transmission Provider reserves the right to interrupt, in whole or in part, firm Transmission Service provided under this Tariff when, in the Transmission Provider's sole discretion, an emergency or other unforeseen condition impairs or degrades the reliability of its transmission system.

The reference to curtailments being allocated on a proportional (pro rata) basis addresses situations where multiple transactions could be curtailed to relieve a constraint.

Concerning the request of certain Pacific Northwest commenters, we would consider granting deference to an alternative curtailment method to avoid hydro spill if such a regional practice is generally accepted and adhered to across the region, as discussed further in Section IV.K.

Finally, we agree with EEI's observation that terminating network service under the tariff to a transmission dependent utility that fails to curtail load as required may not be appropriate. As a result, we clarify that under network and point-to-point service, the transmission provider may propose a rate treatment (penalty provision) to apply in the event a customer fails to curtail load as required under the Final Rule pro forma tariff. Such proposals will be evaluated on a case-by-case basis on compliance.

b. Curtailment Provisions for Non-Firm Service

Comments

A number of commenters seek clarification of the curtailment provision for non-firm service under the two tariffs. They note that economy purchases by the network customer are accorded a higher curtailment priority than non-firm service under the point-to-point tariff. However, under the point-to-point tariff there is no acknowledgement of this higher priority for network service. Curtailments for non-firm transmission service under the point-to-point tariff are simply based upon duration of service, without reference to a higher priority for network economy purchases.

A number of commenters, including Industrial Energy Applications, suggest that a price-based curtailment queue for non-firm transmission will facilitate economy energy deals in highly competitive wholesale power supply markets and allow the parties to directly address delivery risk through the pricing mechanism.

Blue Ridge argues that the final rule should provide equal curtailment priority for all types of non-firm

transmission service. Utilities For Improved Transition argues that network customers should be able to transmit non-firm power imports under the network tariff with the same curtailment priority that is assigned to all other firm network uses of the transmission system.

A number of commenters note that the tariffs allow non-firm service to be interrupted only for emergency or reliability reasons or to provide firm service. These commenters contend that, under this requirement, curtailment of non-firm service is unlikely.[462] As a result, they believe that non-firm service is elevated to firm service. To remedy this situation, these commenters argue that transmission providers should have the ability to

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curtail non-firm service for any economic reason.

Commission Conclusion

We have clarified in the Final Rule pro forma tariff that a network customer's economy purchases have a higher curtailment priority than non-firm point-to-point transmission service.

A higher curtailment priority should be provided to network economy energy purchases for the reasons stated in *AES Power, Inc.*[463] In that case, we recognized that the network transmission customer has already "paid" for the transmission of its economy purchases (*i.e.*, transmission that is used to substitute one resource for another on an as available basis) through its payment of a load ratio share of the system.

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[462] *E.g.*, Florida Power & Light Company, Southern California Edison Company.

[463] 69 FERC ¶61,145, at p. 62,300 (1994) (proposed order), 74 FERC ¶61,220 (1996) (final order).

Many commenters oppose the point-to-point service provision allowing non-firm service to be interrupted only for emergency or reliability reasons or to provide firm service. Upon further consideration, we agree that this provision is too narrow. Accordingly, the Final Rule pro forma tariff is revised to allow the transmission provider to curtail non-firm service for reliability reasons or economic reasons (*i.e.*, in order to accommodate (1) a request for firm transmission service, (2) a request for non-firm service of greater duration, (3) a request for non-firm transmission service of equal duration with a higher price, or (4) transmission service for economy purchases by network customers from non-designated resources.). However, all curtailments must continue to be made on a non-discriminatory basis including curtailments of the transmission provider's own non-firm uses of the transmission system under the tariff. A firm point-to-point customer's use of transmission service at secondary points of receipt and delivery will continue to have the lowest curtailment priority.

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4. Future Filings

We recognize that there may be circumstances in which a public utility believes that the Final Rule pro forma tariff does not provide sufficient flexibility or that the utility can propose superior non-rate terms and conditions. Thus, once the compliance tariff and conforming rates go into effect, which will be 60 days after publication of this Rule in the *Federal Register*, a public utility (either Group 1 or Group 2) may file pursuant to section 205 a tariff with terms and conditions that differ from those set forth in this Rule, provided that it: (1) serves a copy of its filing on all wholesale customers for whom it has provided transmission service since March 29, 1995 (the date of the Open Access

NOPR) and on the state agencies that regulate public utilities in the states where those customers are located; (2) identifies all deviations from its compliance tariff in its letter of transmittal; (3) provides, to the extent practical, a redlined version of the tariff; and (4) demonstrates that such terms and conditions are consistent with, or superior to, those in the compliance tariff. However, it may not seek to litigate fundamental terms and conditions set forth in the Final Rule.[514] In addition, the public utility may file whatever rates it believes are appropriate, consistent with the Transmission Pricing Policy Statement.

5. Waiver

Finally, as noted above, several commenters propose that public utilities that own few transmission facilities be granted waiver, or that application of the Rule to such utilities be deferred until 60 days after they receive a section 211 request. As discussed more fully in Section IV.K.2., we find that it is reasonable to permit certain public utilities for good cause shown to file, within 60 days after this Rule is published in the *Federal Register*, requests for waiver from some or all of the requirements of this Rule. The filing of a request in good faith for a waiver from the requirement to file an open access tariff will eliminate the requirement that such public utility make a compliance filing unless thereafter ordered by the Commission to do so. It will not, however,

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[514] As we stated in our "Further Guidance Order," American Electric Power Service Corp., 71 FERC ¶61,393, 62,539-40, *order on rehearing*, 72 FERC ¶61,267, *order on rehearing*, 74 FERC ¶61,013 (1995), all tariffs need not be "cookie-cutter" copies of the Final Rule tariff. Thus, under our new procedure, ultimately a tariff may go beyond the minimum elements in the Final Rule pro forma tariff or may account for regional, local, or system-specific factors. The tariffs that go into effect 60 days after publication of this Rule in the *Federal Register* will be identical to the Final Rule pro forma tariff; however, public utilities then will be free to file under section 205 to revise the tariffs, and customers will be free to pursue changes under section 206.

exempt such public utility from providing, upon request, transmission services consistent with the requirements of the Final Rule.

I. Federal and State Jurisdiction: Transmission/Local Distribution.

In the original Stranded Cost NOPR, the Commission clarified that it has exclusive jurisdiction over unbundled retail transmission in interstate commerce by public utilities: it found that the Commission has exclusive jurisdiction over the rates, terms, and conditions of unbundled retail transmission in interstate commerce by public utilities, up to the point of local distribution. In the Open Access NOPR, the Commission reaffirmed this jurisdictional determination[515] and also

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addressed the distinction between transmission and local distribution. The Commission stated three reasons for expressing its views on the distinction between Commission-jurisdictional transmission in interstate commerce and state-jurisdictional local distribution, in the context of unbundled retail wheeling by public utilities.[516] First, facilities that can

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[515] That determination included the situation in which a former bundled retail customer may need unbundled wheeling services from its previous public utility generation supplier, as well as unbundled wheeling from one or more intervening public utilities, in order to reach a distant generation supplier. In that scenario, the commission would have jurisdiction over all of the transmission facilities used for the unbundled wheeling provided by the intervening public utilities. The NOPR also noted that the Commission would not have jurisdiction over the rates for the sale of generation by the distant supplier because the transaction would be a retail sale. *FERC Statutes and Regulations* ¶ 32,514 at p. 33,144.

[516] The term "wheeling" is intended to cover any delivery of electric energy from a supplier to a purchaser, *i.e.*, transmission, distribution, and/or local distribution. The Commission also has jurisdiction to order wholesale transmission services in either interstate or intrastate commerce

be used for wholesale transmission in interstate commerce by a public utility would be subject to the Commission's open access requirements. Second, states have authority to address retail stranded costs and stranded benefits through their jurisdiction over facilities used in local distribution. Third, as the structure of the industry continues to change dramatically, utilities need to know which regulator has jurisdiction over which facilities and services in order to meet state and federal filing requirements. Accordingly, the NOPR set forth our jurisdictional analysis and several technical factors, for determining what constitutes "facilities used in local distribution."

For unbundled wholesale wheeling, the NOPR proposed to apply a functional test, *i.e.*, whether the entity to whom the power is delivered is a lawful reseller. For unbundled retail wheeling, the NOPR proposed to apply a combination functional-technical test that would take into account technical characteristics of the facilities used for the wheeling. The Commission proposed seven indicators of local distribution to be evaluated on a case-by-case basis:

(1) Local distribution facilities are normally in close proximity to retail customers.

(2) Local distribution facilities are primarily radial in character.

(3) Power flows into local distribution systems; it rarely, if ever, flows out.

(4) When power enters a local distribution system, it is not reconsigned or transported on to some other market.

(5) Power entering a local distribution system is consumed in a comparatively restricted geographical area.

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by transmitting utilities that are not also public utilities. *See Tex-La Electric Cooperative of Texas, Inc.*, 67 FERC ¶61,019 (1994), *reh'g pending*.

(6) Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.

(7) Local distribution systems will be of reduced voltage.[517]

The NOPR concluded that the application of these tests will enable states to address stranded costs by imposing an exit fee on departing retail customers, or including an adder in the retail customers' local distribution rates.[518]

In the NOPR, the Commission also addressed buy-sell transactions in which an end user arranges for the purchase of generation from a third-party supplier and a public utility transmits that energy in interstate commerce and re-sells it as part of a "nominal" bundled retail sale to the end user. We explained that the retail sale is actually the functional equivalent of two unbundled sales (one transmission and the other the sale of power) and that we have exclusive jurisdiction over the voluntary sale by public utilities of unbundled transmission at retail in interstate commerce.[519]

Comments

Several commenters support the Commission's proposed jurisdictional demarcation.[520]

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San Diego G&E states that the Commission correctly proposed to look at both functional factors (such as whether the service is retail or wholesale) and technical factors (such

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[517] *FERC Statutes and Regulations* ¶32,514, at p. 33,145.

[518] *Id.* at pp. 33,144-45.

[519] As discussed *infra*, there also would be a component of local distribution in such a transaction that would be subject to state jurisdiction.

[520] *E.g.*, PG&E, Wisconsin Coalition, Com Ed.

as voltage). PG&E states that the NOPR's functional/technical test is preferable to a bright line voltage test.

Consumers Power states that the Commission has exclusive jurisdiction over all wheeling on an interconnected interstate transmission grid. It suggests that the Commission and the states act through a joint board or hearing to resolve jurisdictional differences and develop a bright line test.

PSE&G and PG&E express concern that if retail wheeling is implemented, there may be loopholes that would enable customers to evade state jurisdiction and thus avoid paying stranded costs. For example, PSE&G is concerned that a retail customer may request transmission service only and a state commission will be unable to attach a retail stranded cost surcharge to that customer. PG&E proposes adding another indicator to the functional/technical test—a final tap to a retail customer—to ensure that "high-voltage" retail customers do not evade the state's reach. Moreover, to ensure that retail customers cannot escape state jurisdiction, PG&E recommends that the Commission state, as a matter of policy, that *all* retail customers taking retail transmission service from their host utility, *by definition* take service over local distribution facilities."

CINergy agrees with the Commission that a distinction between transmission and local distribution is important, but emphasizes the practical need for clarity on a timely basis. To achieve certainty, CINergy proposes that the Commission allow public utilities to file, under section 205, classifications of their facilities as transmission or local distribution. CCEM endorses CINergy's proposal. Although NARUC disagrees that the Commission has jurisdiction over unbundled retail transmission, if the Commission reaffirms the NOPR regarding its jurisdiction, then NARUC supports CINergy's proposal.

PSE&G strongly supports the Commission's proposed case-by-case methodology for determining whether facilities should be classified as transmission or local distribution. SoCal Edison argues that since a utility may have difficulty determining which of its facilities are transmission and which are local distribution, utilities and states should be able to ask the Commission to classify a particular facility. Portland and Orange & Rockland suggest that the Commission provide a forum to resolve disputes over the correct classification of particular facilities.

Ohio Edison states that the Commission should assume jurisdiction over unbundled retail transmission, but only where a state has required this unbundling. It also believes that the Commission should assert jurisdiction over the ancillary services necessary to provide this jurisdictional service.

NYSEG argues that the Commission lacks jurisdiction over the transmission component of bundled retail service. On the other hand, NYSEG argues that the statute, legislative history, and case law reveal that the Commission has jurisdiction over unbundled retail wheeling from source to load, since it is transmission in interstate commerce. NYSEG argues that the "local distribution" exception to the Commission's jurisdiction applies only to bundled sales of power at retail.

Several state commissions assert that states have rate authority over all facilities used to provide retail service.[521] IL Com argues that states have rate authority over all facilities used to provide retail service, regardless of whether the NOPR would classify these facilities as transmission or local distribution.

MI Com, citing *Connecticut Light & Power Company v. Federal Power Commission*, 324 U.S. 515 (1945) CL&P),

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[521] *E.g.*, NM Com, NC Com, AZ Com.

and *Arkansas Electric Cooperative v. Arkansas Public Service Commission*, 461 U.S. 375, 393-94 (1983), contends that states have plenary jurisdiction over all aspects of retail service, including retail access and unbundled retail transmission service. It asserts that the Commission's effort to expand federal jurisdiction into transmission in connection with retail sales is without statutory justification.

Legal Environmental Assistance argues that the NOPR creates confusion about, and may intrude onto, state jurisdiction.

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NYMEX argues that when a state orders retail wheeling, the state should have jurisdiction over that transmission-only service.

Oklahoma G&E, citing *CL&P* and *United States v. California Public Utilities Commission*, 345 U.S. 295, 316 (1953), asserts that the Commission failed to explain that the term "transmission in interstate commerce" could have different meanings depending on the factual context in which the term is applied. It argues that "transmission in interstate commerce" means the movement, in bulk, of electric energy flowing in interstate commerce, as opposed to the movement of electric energy that has been subdivided for delivery to consumers.

Oklahoma G&E further argues that "[t]he distinction between interconnected operation and radial operation corresponds precisely to this distinction between activities that have potential interstate effects and those that might have interstate effects but are a matter of primarily local concern."[522] Oklahoma G&E also disagrees that the transportation of electric energy sold at wholesale necessarily constitutes transmission in interstate commerce. It argues that

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[522] Oklahoma G&E Initial Comments at p. 16.

the Commission has misapplied case precedent and, by focusing on the level of the associated power sale, the Commission has misunderstood what constitutes a functional distinction between transmission in interstate commerce and local distribution.

NY Com asserts that the grant of jurisdiction to the Commission over wholesale power transactions in interstate commerce under section 201 of the FPA does not reduce the states' authority over local distribution (citing *CL&P* and *Federal Power Commission v. Florida Power & Light Company*, 404 U.S. 453, 467 (1972)). NY Com argues that the NOPR's assertion of exclusive jurisdiction over all facilities used to deliver electricity for resale, even those traditionally regarded as local distribution, violates Congress' assignment of local electric distribution to the states. It takes issue with the Commission's list of factors and says that states and the Commission should agree on a definition that preserves the traditional classification of local distribution facilities. According to NY Com, such definition should focus on the functional characteristics of local electric systems—*i.e.*, electricity flows into a comparatively restricted geographic area and does not flow back out of that area, and the power is consumed in that area.

NY IOUs argue that the Commission has jurisdiction over unbundled, but not bundled retail wheeling. It says that other factors, including the indicators listed in the NOPR, are irrelevant, and that even long-distance interstate transmission is under state jurisdiction as long as it is bundled with a retail sale. According to NY IOUs, this is the plain meaning of the FPA; resort to legislative history is unnecessary. NY IOUs bases this view on section 201(a), which says that federal regulation extends only to matters not subject to state regulation. NY IOUs says that the only matters subject to state regulation were bundled retail sales, and that since transmission was part of the bundle, Congress intended transmission to stay under state authority as long as it is part

of that bundle. It also cites section 201(b), which sets forth exceptions from Commission jurisdiction, and section 201(c), which defines "transmission in interstate commerce" and thus also controls the definition of transmission in intrastate commerce. Finally, NY IOUs argues that the legislative history supports its view, as does the case law.

Central Louisiana believes that the costs of requiring a transmission provider to take unbundled transmission service for both wholesale and retail purposes would far exceed any benefits. In this regard, Central Louisiana says that states clearly have jurisdiction over bundled retail transmission charges and that the proposed approach could not be implemented without states giving up jurisdiction or the passage of new federal legislation.

MN DPS disagrees on legal and policy grounds with the Commission's assertion of jurisdiction over unbundled retail transmission services.[523] It maintains that the Commission's arguments do not negate the language of the FPA specifying that regulation of retail sales of electric energy is reserved to the states. MN DPS argues that the Commission's arguments

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in support of its position are not on point because the issue is state authority to set rates for retail sales, not interstate commerce. Further, it declares that jurisdiction over a service does not change simply because it is priced differently.

Several commenters argue that unbundled pricing should not expand the Commission's jurisdiction.[524] NARUC argues that the NOPR did not explain why the Commission's authority attaches only to unbundled retail transmission service, why unbundling is jurisdictionally significant, and how transmission of electricity to end users differs from

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523 *See also* OH Com.

524 *E.g.*, DOD, NM Com, KY Com, ABATE.

unbundled interstate transmission of natural gas by local distribution companies, which is subject to state regulation. Thus, NARUC urges the Commission not to claim jurisdiction over unbundled retail transmission services.

NARUC also argues that the Commission's test for distinguishing between transmission and local distribution is not a bright line as discussed in *Federal Power Commission v. Southern California Edison Company*, 376 U.S. 205 (1964) (Colton). NARUC concludes that when a state determines to enable a retail customer to purchase power from a third-party provider, that state retains the authority to regulate the delivery service provided by the utility.

IL Com asserts that the test should be whether the utility function over which the Commission seeks to exercise jurisdiction is one which falls within the *Attleboro* gap.[525] It argues that the Commission has no legal authority to prescribe conditions under which a public utility may provide transmission service within its own service territory to its own retail customers. IL Com concedes that the court cases cited by the Commission can be interpreted to support widely disparate legal and policy positions, but argues that those cases resolved questions of Commission jurisdiction in circumstances where wholesale sales of electric power were being examined and not circumstances where retail sales are being considered. It contends that the question of whether the Commission should exercise jurisdiction over all transmission in retail wheeling has never been addressed before and requires a careful examination of the underlying purposes of Congress in enacting the FPA. IL Com explains that transmission by an Illinois utility of power to a retail consumer within its own service territory is not subject to Commission jurisdiction because that transmission was never

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[525] *See Public Utilities Commission v. Attleboro Steam & Electric Company*, 273 U.S. 83 (1927).

within the *Attleboro* gap and has always been regulated by states.

OK Com recommends that the Commission apply to the electric industry the same policy that it has adopted concerning its regulation of the gas industry and leave unbundled retail service regulation to state authorities.

WI Com argues that if a utility offers unbundled retail access, jurisdiction over transmission services should continue to be based upon the historical demarcation between wholesale and retail transactions. KY Com argues that Congress did not intend, by authorizing wholesale wheeling in the Energy Policy Act, to change the longstanding division of jurisdiction between the Commission and the states. It claims that the NOPR ignores the limitation in the FPA that the Commission has no jurisdiction over retail sales service. NV Com cites several cases noting the states' historical authority to regulate retail rates.

IA Com proposes a definition of local distribution and transmission that would preserve the jurisdictional status quo and does not put a state commission in the position of losing authority over certain elements of a retail transaction should it allow retail wheeling. IA Com's proposed definition is as follows:

Distribution—Service provided by a utility directly connected to an ultimate consumer of electricity is a distribution service with respect to electric energy delivered to that consumer.

Transmission—Service provided by a utility with respect to electric energy to be delivered to an ultimate consumer through another utility is a transmission service.[526]

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526 IA Com Initial Comments at p. 4.

Montana Power states that a reasonable way to give effect to the "local distribution" exemption is to define "local distribution" as a bundled retail sale, even if interstate facilities are used.

Several commenters criticized the NOPR's functional/physical indicators. PA Com disagrees with the Commission's discussion of the FPA's legislative history and asserts that the FPA does not address the issue of what constitutes local distribution. PA Com contends that the issue was resolved by the Supreme Court in *CL&P* in a manner contrary to the Commission's technical-functional test and that the NOPR minimized *CL&P*. NM Com asserts that the proposed engineering and functional elements for determining the status of local distribution facilities fail to account for the governmental or legalistic test requirement of the FPA as identified in *CL&P*.

KY Com concludes that a physical definition of distribution facilities, based on objective criteria, is consistent with the FPA and is necessary to provide a clean line of demarcation.

CO Com argues that Congress used a transactional test rather than a functional test and that Congress intended all retail transactions to be under state jurisdiction. According to CO Com, there is concurrent jurisdiction over unbundled transmission in interstate commerce to an end-user. Moreover, CO Com asserts that unbundled intrastate transmission to a wholesale purchaser is under state jurisdiction (citing section 201(b)(1)). Finally, CO Com argues that the state has authority over unbundled transmission in intrastate commerce to an end-user when the transmission-providing utility, end-user, and generator are all within the same state.

Other commenters prefer a functional test. Natural Resources Defense, DOE, and Sustainable Energy Policy generally agree that a line needs to be drawn between

transmission and local distribution but believe that the Commission's test is unnecessarily cumbersome or may lead to legal uncertainty, at least within the context of stranded benefits. Instead, Natural Resources Defense proposes the following functional test, which is based on end-use service:

The Federal Power Act does not affect state regulators' jurisdiction to apply distribution charges—either volume-based or fixed—to electricity that is used by any utility customer to provide end-use services (as distinguished from electricity that is purchased for resale to end-use customers).[527] Sustainable Energy Policy endorses Natural Resources Defense's position. DOE suggests that a functional definition of local distribution (*i.e.*, electricity provided for end-use service) may be the best way to avoid legal uncertainty.

EPA argues that the Commission's proposed physical definition may encourage gaming to avoid stranded costs and costs associated with public policy goals such as energy efficiency, renewable energy development and R&D funding, and a physical definition assumes that power flows into, and not out of, distribution systems, which would not allow for distributed generation (*e.g.*, fuel cells). Thus, EPA urges the Commission to adopt a functional definition that "local distribution occurs whenever electricity is provided by a utility for end-use service." Alternatively, EPA suggests that the Commission add a provision to its approach that "the provision of electricity for end-use service generally involves local distribution." Sustainable Energy Policy suggests a non-bypassable charge levied on all users of the distribution system. It endorses the policy formulation set forth by Natural Resources Defense in its initial comments. Reynolds wants to ensure that there is always at least concurrent state jurisdiction over lines used to serve end-use customers, since only states can order retail wheeling.

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[527] Natural Resources Defense Initial Comments at p. 3.

Detroit Edison argues that state/federal jurisdictional issues should be resolved by focusing on the use of the facilities. It says that facilities that are used to distribute a utility's own power to its own local customers should be subject to state regulation, while the use of facilities for wholesale power transactions or wholesale or retail transmission in interstate commerce should be under federal regulation.

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Mountain States Petroleum Assoc argues that the Commission should use a functional test based on state boundaries: if a line is in more than one state, there is Commission jurisdiction; if a line is entirely within one state, there is state jurisdiction.

MD Com states that it believes that the Commission's proposed indicators for determining where to draw the line are adequate, but adds that it does not concede the Commission's assertion of jurisdiction over unbundled retail transmission.

Some commenters suggest that implementation of the NOPR's tests could have adverse consequences. NH Com objects to the NOPR's specific tests; for example, if the Commission asserts jurisdiction over facilities because they are not radial, New Hampshire's policy of encouraging looping rather than radial lines would have the ironic effect of destroying state jurisdiction. NJ BPU states that there may be situations when the NOPR factors would not produce the proper result. It requests that the final rule recognize the need for case-by-case flexibility in determining where federal jurisdiction ends, so that the Commission and the states can work cooperatively.

NRRI argues that the NOPR's test could make siting of new transmission lines more difficult because states have in the past required native load customers to pay that part of the transmission-related revenue requirement that is not covered

by unbundled transmission service. NRRI contends that, if the Commission asserts jurisdiction over all unbundled transmission service and if there is a firm point-to-point service capacity right that has value and is reassignable, then state commissions might eliminate portions of the transmission systems subject to capacity rights from rate base. NRRI is also concerned that the NOPR's transmission/local distribution test could create a price squeeze between bundled and unbundled retail transmission rates.

IN Com argues that the NOPR's view of jurisdiction would discourage retail wheeling. It says that states will be reluctant to order wheeling if the result is that they lose jurisdiction over the previously rolled-in transmission aspect of the service. It suggests that the Commission use negotiated rulemaking to address jurisdictional issues.

Several commenters suggest alternative approaches to jurisdictional line-drawing. NV Com suggests that the Commission consider federal and state jurisdiction over transmission by using "network" and "non-network" concepts:

The "network" concept for regulation recognizes that there is an interstate network of electric facilities used to link generation with loads. The operation of that network is indifferent to whether the electrical flows are retail or wholesale flows. Conceptually, events on the network could fall under federal jurisdiction. Where facilities provide essential service for the delivery of power, but do not substantially affect the electrical flows on the network, the facilities fall outside the network and would remain within the traditional domain of the state commission. As a consequence the delineation of federal and state jurisdiction evolves from the recognition of the events and where they

occur as opposed to a rigid consideration of the physical properties of the facilities involved.[528]

NV Com further explains that the determination of what is a network event would require a case-by-case examination.

OH Com asserts that Congress intends there to be a bright line between state and federal jurisdiction and that the Commission has failed to provide such a bright line. OH Com proposes the use of retail marketing areas to provide the bright line—the jurisdictional line would be at the point at which power enters the retail marketing area of the entity delivering the power to the retail customer. OH Com cites section 212(g) of the FPA, as amended by the Energy Policy Act, which provides that the Commission cannot issue any order under the FPA inconsistent with state law governing retail marketing areas.

Under OH Com's proposal, the Commission would have jurisdiction over the wheeling-out and wheeling-through components of retail wheeling and the state would have jurisdiction over the wheeling-in component due to its local nature. OH Com concludes that the Commission's approach "fails to meet the legal standard

[31,777]

FERC must consider, and is inconsistent with the 'savings clause' and legitimacy of 'retail marketing areas' as discussed in the amended FPA."[529] OH Com also explains that the Commission's approach "is wreaking havoc on the state's ability to develop an interruptible buy-through arrangement to provide an increased competitive option for its retail customers."[530] OH Com further encourages the use

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528 NV Com Reply Comments at p. 3.

529 Sections 212(g) and 212(h) of the FPA.

530 We note that since OH Com filed its comments, it approved an interruptible buy-through plan. *See Interruptible Electric Service*

of mutual deference to promote Congress' intent in mandating a system of federal/ state cooperation. In support, OH Com cites federal and state enforcement of telecommunications laws. NRRI also suggests that the jurisdictional line be drawn at the retail marketing area.

DC Com argues that the NOPR test is too difficult to administer and will create problems in determining the rate base at the state level. It suggests that the Commission should have jurisdiction over transmission from the source to the boundary of the "home" utility that delivers the power to the customer, with state jurisdiction over all aspects of the transmission service within that utility's franchise territory. AZ Com also expresses doubts that the NOPR's test is workable.

Several commenters propose that the Commission and state authorities address the jurisdictional issue jointly. SBA characterizes the Commission's proposed demarcation line as "laudable but misguided."[531] SBA recommends that a federal/state board be established to resolve the transmission/local distribution dilemma, similar to what Congress did for allocating costs between interstate and intrastate communications. SBA explains that the problem in the communications industry was the impossibility of

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Guidelines, Case No. 95-866-EL-UNC,—PUR 4th—(Ohio PUC Feb. 15, 1996). *See also Central Illinois Light Company*, Docket No. ER96-1075-000 (1996) (accepting amendment to open access transmission tariffs that expands service eligibility to accommodate participation in experimental retail wheeling pilot program approved by the Illinois Commerce Commission); *Illinois Power Company*, Docket No. ER96-1285-000, 75 FERC (1996); *cf. Illinois Power Company*,—PUR4th—, No. 95-0494 (Illinois Commerce Commission Mar. 13, 1996) (offering retail direct access service providing transmission and ancillary services using the rates, terms, and conditions of Illinois Power's open access tariff on file with the Commission); recently introduced legislation in Rhode Island, H.B. 8124, the Utility Restructuring Act of 1996.

[531] SBA Initial Comments at p. 36.

allocating a portion of a single copper wire to interstate or intrastate service.

AZ Com notes that even if the Commission is correct, the FPA clearly does not preempt a state from concluding that retail transmission or other direct access programs should be implemented in that state. AZ Com suggests that there may be concurrent jurisdiction and that mutually agreed-upon principles should be implemented to determine which jurisdiction should be given deference.

MD Com states that in determining the status of particular facilities, the Commission should give substantial weight to determinations made by states. ABATE states that the Commission could initially defer to states with respect to the determination of rates, terms, and conditions, while maintaining the right to review and overturn the state determination.

If the Commission maintains its position concerning jurisdiction, NARUC argues that the Commission should not implement its multi-factor test, but should enter into discussions with state commissions to develop workable alternatives. NH Com argues that pricing the retail part of a transaction, even if it involves use of the transmission system, should be subject only to state jurisdiction. NH Com wants to create a mechanism by which state and federal regulators combine their efforts in cooperative regulation; it suggests several alternatives such as state/federal agreements for shared jurisdiction.

KY Com and NRRI object to the statement in the NOPR that retail buy-through service is really transmission service (subject to the Commission's jurisdiction) plus a sale of generation at retail (subject to state jurisdiction). From a policy standpoint, KY Com argues that the Commission's approach creates a powerful disincentive for a state to embark on changes that otherwise might foster a more competitive environment. NRRI argues

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that the Commission's approach may violate sections 212(g) and 212(h).

IL Com is concerned that industrial customers who get direct access may attempt to evade state jurisdiction, and thus avoid retail stranded cost charges, by bypassing facilities such as radial lines. It contends that retail wheeling rate surcharges would be a more effective means of recovering retail stranded costs if states were allowed to apply them to unbundled transmission and local distribution rates, not just the local distribution component of such rates.

NC Com asserts that "[a] significant cottage industry may well arise solely to convert retail customers into wholesale customers, thereby subverting the intent of Congress as expressly set forth in EPACT."[532] If the Commission does not adopt NARUC's proposal, NARUC asserts that the Commission's functional test should not permit an end user to bypass the distribution service provided by the utility. It urges the Commission to assure that there will be some facility involved in the transaction that will be defined as providing a local distribution service.

NARUC also requests that the following sentence be added to proposed 18 CFR 35.27:

Nothing in this part limits the authority of a State commission in accordance with State law (1) to allow or disallow the inclusion of the costs of electric energy purchased at wholesale in retail rates subject to such State commission's jurisdiction, (2) to establish competitive procedures for the acquisition of such electric energy, or (3) to establish non-discriminatory fees for the delivery of such

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532 NC Com Initial Comments at p. 7.

electric energy to retail consumers for purposes established in accordance with State law.[533]

Duke is concerned about the potential for regulatory gaps, which could lead to costs not being recovered from either federal or state jurisdiction. Duke is also concerned that where facilities are used for both wholesale and retail transactions, costs might not be recovered if federal and state regulators use different methods of cost allocation.

In response to the NOPR's proposal for functional unbundling,[534] CA Com agrees that it is important to draw a distinction between transmission and local distribution and that a bright line is not possible, but suggests that corporate or functional unbundling might provide a means to establish a workable bright line without relying on the more qualitative approach proposed in the NOPR. Arizona argues that rather than unbundling transmission for retail purposes, each utility should establish a distribution function that would obtain transmission on behalf of retail customers, taking service under the utility's tariff. Arizona states that this would simplify the allocation of transmission costs, since all transmission costs would be under the Commission's jurisdiction. Arizona argues that the Commission should permit the utility to recover the distribution rate approved by the state. According to Arizona, this would create a bright line between state and federal jurisdiction.

TX Com argues that the proposed test would not be applicable to intrastate utilities in Texas because they do not operate in interstate commerce. Thus, it asserts that it should continue to regulate Electric Reliability Council of Texas (ERCOT) transmission and distribution service and deal with stranded cost issues that arise in connection with any retail wheeling initiatives.

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533 NARUC Reply Comments at p. 15-16.

534 *FERC Statutes and Regulations* ¶32,514, at pp. 33,080-83.

Several commenters object to the Commission's proposal to assert jurisdiction over transactions that are buy-sell transactions in name only.[535] AEP argues that the Commission should avoid an unnecessary conflict over state/federal jurisdiction that may be caused by the NOPR's statement that buy-sell transactions are in fact transmission subject to Commission jurisdiction. It suggests that the Commission attempt to reach agreement with the states on this matter or ask Congress for any necessary statutory change. Citizens Utilities also argues that the Commission should not unbundle the interstate transmission aspect of buy-sell transactions. It says that, unlike the analogous

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gas contracts, buy-sell arrangements on the electric side are not an end run around clear federal jurisdiction. Further, it argues that it would be very difficult to define those buy-sell transactions that truly belong under federal jurisdiction.

IL Com also objects to the NOPR's characterization of buy-sell transactions. It argues that the fact that a transaction becomes unbundled does not suddenly make part of it under federal jurisdiction. Nucor argues that there is no need for the Commission to resolve this issue now; it suggests that the buy-sell arrangement is only tangentially related to open access. It argues that each buy-sell transaction will have to be addressed individually.

UT Com seeks clarification as to what the Commission means by buy-sell arrangements:

we currently authorize interruptible "buy-through" contracts, through which a retail customer, taking service subject to interruption for either economic or technical reasons, can opt to "buy-through" an interruption. The public utility purchases energy on behalf of the customer and sells it at cost to the

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[535] *See id.* at p. 33,082.

customer. In our opinion, such transactions are not an example of a buy-sell transaction within the meaning of the proposed rule.[536]

DOD objects to the statement in the NOPR that "buy-sell" transactions are not really bundled retail service. It says that this view will discourage the development of innovative state programs, such as direct access programs. NYSEG also argues that buy-sell transactions are not under the Commission's jurisdiction. It argues that these transactions are unlike buy-sell transactions on the gas side, where the Commission asserted jurisdiction to prevent LDCs from circumventing the nondiscrimination standard it imposed on the release of capacity. NYSEG says:

In contrast to its regulation of gas buy-sells, if the Commission regulates electric buy-sell transactions it would forego regulation of a transaction in which the Commission has a significant interest (*i.e.*, access to the upstream seller's transmission), to regulate a transaction in which the Commission has virtually no interest (*i.e.*, access to the distributing utility's system). Electric utilities must serve each retail customer irrespective of whether the customer takes traditional bundled service or retail buy-sell service. Unlike excess upstream gas pipeline capacity, the capacity on the local utility's electric system would not be allocated to another customer in a FERC jurisdictional transaction absent the electric buy-sell transaction. Electric buy-sell transactions are not designed so as to manipulate the assignment of upstream transmission capacity. Consequently, the impetus for FERC to reclassify gas buy-sell transactions as capacity assignments is not present in the electric context.[537]

NYSEG argues that there are only two possible grounds for the Commission's assertion of jurisdiction over electric

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536 UT Com Initial Comments at p. 4-5.

537 NYSEG Initial Comments at p. 48 (footnote omitted).

buy-sell transactions: either (1) the sale for resale by the supplier is really a sale at retail to the end user, and the resale by the local utility is really unbundled retail wheeling; or (2) the Commission has jurisdiction over transmission service that is part of bundled retail service. It claims that the second ground is invalid because the transmission aspect of bundled retail service is distribution. It also claims that the first ground is invalid because it assumes that the sale by the supplier to the local utility is not a sale for resale even though the contract says that it is. NYSEG states:

The logical outcome would be that FERC would *not* have jurisdiction over the sale by the supplier to the utility, including transmission by that supplier because it would be a bundled retail sale. This is because, if the commission holds the resale to be a retail wheel, then it would have to find that the sale by the supplier is a retail sale to the end user. The Commission cannot at once regulate the sale for resale and the "retail transmission service." The Commission would regulate the transmission rates of the local franchise utility, although it would not regulate the access to such transmission service—a matter FERC leaves to state regulators. In the process, FERC

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would abandon the ability to regulate access to the supplier's bundled "retail power sale and transmission service," a transaction that FERC arguably has an interest in regulating.[538]

Finally, NYSEG argues that if the Commission insists on asserting jurisdiction, it should at least grandfather existing contracts.

UT Industrials state that where there is a state barrier to a buy-sell transaction, the Commission should allow the utility

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538 NYSEG Initial Comments at p. 50.

to file a tariff with the Commission that would permit the utility to complete a voluntary buy-sell transaction as the NOPR proposes. However, it contends that when a state regulatory authority is authorized to, and has approved buy-sell transactions, it is not necessary for the Commission to become involved. It urges the Commission to allow such transactions to take place free of Commission regulation.

Commission Conclusion

In the discussion below, the Commission addresses the following jurisdictional issues raised in the prior NOPRs:

a. Does the Commission have jurisdiction over unbundled transmission in interstate commerce by a public utility when such transmission is used to transport electric energy that is sold to an end user?

b. If so, what facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to an end user?

c. What facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to a purchaser who will then re-sell the energy to an end user?

d. What procedures are appropriate for making jurisdictional determinations?

In addition, the Commission addresses concerns raised by state regulators which indicate that competition and open access are perceived as threatening the traditional regulatory functions of state commissions. The Federal Power Act differentiates between state and federal regulation of electric power. As we discuss below, the Commission believes that any change in state or federal jurisdiction over physical transmission assets and related costs will not affect the traditional tasks of state and federal regulators.

The wide range of jurisdictional interpretations and proposals in the comments reflects the fact that the legislative history of the FPA and case law interpreting federal/state jurisdiction under that Act and the Natural Gas Act grew out of a market structure in which electricity and transmission generally were bought and sold on a bundled basis. As a result, most transactions included either a retail or wholesale sale of electric energy and jurisdictional lines were drawn on the basis of this sale. Thus, the cases simply do not resolve dispositively these jurisdictional issues when they arise in the context of the market structures and unbundled transactions being contemplated in today's electric industry. However, after reviewing the extensive analysis of the FPA, legislative history, and case law contained in both our initial Stranded Cost NOPR and in our Open Access NOPR, and the comments received on that analysis, we continue to believe that we were correct in asserting jurisdiction over the transmission component of an unbundled interstate retail wheeling transaction. We therefore reaffirm our conclusion. We also reaffirm and clarify our determinations regarding the tests to be used to determine what constitute Commission-jurisdictional transmission facilities and what constitute state-jurisdictional local distribution facilities in situations involving unbundled wholesale wheeling and unbundled retail wheeling.[539]

At the same time, the Commission strongly supports the efforts of states to pursue pro-competitive policies. We recognize that jurisdictional issues raise overlapping Federal and state policy concerns that call for heightened cooperation among federal and state regulators. As discussed below, where states unbundle

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[539] Not only do we conclude that our determinations are legally supportable under the case law, but we believe it is imperative to provide guidance to public utilities and state regulators as to our position on where the jurisdictional boundaries lie.

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retail sales, we will give deference to their determinations as to which facilities are transmission and which are local distribution, provided that the states, in making such determinations, apply the seven criteria discussed in the NOPR and reaffirmed below. In addition, we clarify our view that there is an element of local distribution service in any unbundled retail transaction, and further clarify other aspects of our jurisdictional ruling to preserve state jurisdiction over matters that are of local concern and will remain subject to state jurisdiction if retail unbundling occurs.

We first address our legal determination that if unbundled retail transmission in interstate commerce occurs voluntarily by a public utility or as a result of a state retail access program, this Commission has exclusive jurisdiction over the rates, terms, and conditions of such transmission. No commenter has raised cases or legislative history not previously considered in our prior NOPRs, and we will not repeat here our full legal analysis of this issue.[540] However, we find compelling the fact that section 201 of the FPA, *on its face*, gives the Commission jurisdiction over transmission in interstate commerce (by public utilities) without qualification.[541] Unlike our jurisdiction over sales of electric energy, which section 201 of the FPA specifically limits to sales at wholesale, the statute does not limit our transmission jurisdiction over public utilities to wholesale transmission.

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[540] The Commission's complete legal analysis on this issue, and on the related issue of what facilities are Commission-jurisdictional transmission facilities, and what are state jurisdictional local distribution facilities, are contained in Appendix G to this Rule.

[541] Section 201(b)(1) specifically exempts from Commission jurisdiction facilities used for transmission in intrastate commerce and transmission of electric energy consumed wholly by the transmitter. As a result, we have no jurisdiction over retail wheeling that occurs in Alaska, Hawaii and the Electric Reliability Council (ERCOT) portion of Texas since transactions in those areas are intrastate.

In response to those commenters (including NARUC) who argue that the Commission did not explain why its authority attaches only to unbundled, but not bundled, retail transmission in interstate commerce by public utilities, we believe that when transmission is sold at retail as part and parcel of the delivered product called electric energy, the transaction is a sale of electric energy at retail. Under the FPA, the Commission's jurisdiction over sales of electric energy extends only to wholesale sales. However, when a retail transaction is broken into two products that are sold separately (perhaps by two different suppliers: an electric energy supplier and a transmission supplier), we believe the jurisdictional lines change. In this situation, the state clearly retains jurisdiction over the sale of the power. However, the unbundled transmission service involves *only* the provision of "transmission in interstate commerce" which, under the FPA, is exclusively within the jurisdiction of the Commission. Therefore, when a bundled retail sale is unbundled and becomes separate transmission and power sales transactions, the resulting transmission transaction falls within the Federal sphere of regulation.

In asserting jurisdiction over unbundled retail transmission in interstate commerce by public utilities, the Commission in no way is asserting jurisdiction to order retail transmission directly to an ultimate consumer. Section 212(h) of the FPA clearly prohibits us from doing so. In addition, as stated in both the initial Stranded Cost NOPR and the Open Access NOPR, we do not address whether states have authority to order retail wheeling in interstate commerce. The Commission's assertion of jurisdiction is that *if* retail transmission in interstate commerce by a public utility occurs voluntarily or as a result of a state retail wheeling program, the Commission has exclusive jurisdiction over the rates, terms, and conditions of such transmission and public utilities offering such transmission must comply with the FPA by filing proposed rate schedules under section 205.

The Commission clarifies that nothing in this jurisdictional determination changes historical state franchise areas or interferes with state laws governing retail marketing areas of electric utilities. Section 212(g) of the FPA prohibits Commission orders that would be inconsistent with such laws. However, we reject arguments made by some of the commenters

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that section 212(g) could somehow be construed to give states authority over the rates, terms, and conditions of unbundled interstate transmission within retail marketing areas.[542] While our jurisdiction cannot affect whether and to whom a retail electric service territory (marketing area) is to be granted by the state, and whether such grant is exclusive or non-exclusive, neither can state jurisdiction affect this Commission's exclusive jurisdiction over transmission in interstate commerce by public utilities.

In response to several of the commenters, we further clarify that the Commission's jurisdiction over the rates, terms, and conditions of unbundled retail transmission is no broader than our authority over transmission used for wholesale transactions, and will not affect matters otherwise

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[542] The legislative history of FPA section 212(g) and its predecessor, former section 211(c)(3), indicates that the provision was focused on not interfering with state laws governing retail service territories and not permitting Commission wheeling orders "for purposes of sale by a utility to an ultimate consumer who is within the service territory of another utility (other than the applicant) where such territory is established by or under State law, rule, or decision." *See* H.R. Conf. Rep. No. 1750, 95th Cong., 2d Sess. 92 (1978), *reprinted* in 1978 *U.S. Code Cong. & Ad. News* 7797, 7826. Nothing on the face of section 212(g) or the legislative history of either the Energy Policy Act or PURPA indicates that the provision in any way affects the Commission's authority over rates, terms, and conditions of transmission in interstate commerce by public utilities.

left to the states by Congress.[543] The Federal Power Act recognizes that retail marketing areas are governed by state law. Moreover, we believe that states have authority over the *service* of delivering electric energy to end users. In exercising this authority, state regulatory commissions and state legislatures have traditionally developed social and environmental programs suited to the circumstances of their states. State regulation of most power production and virtually all distribution and consumption of electric energy is clearly distinguishable from this Commission's responsibility to ensure open and non-discriminatory interstate transmission service. Nothing adopted by the Commission today, including its interpretation of its authority over retail transmission or how the separate distribution and transmission functions and assets are discerned when retail service is unbundled, is inconsistent with traditional state regulatory authority in this area.

The Commission reiterates its strong interest in preventing any balkanization of the interstate power market. Although the Commission believes its Final Rule will accommodate retail competition, if it is offered voluntarily by a utility or ordered by a state, our policies relate only to the bulk power market and not traditional state regulation of the retail market.[544]

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[543] Among other things, Congress left to the States authority to regulate generation and transmission siting. *See* FPA sections 201(b) and 211(d)(1); Section 731 of the Energy Policy Act.

[544] This Final Rule will not affect or encroach upon state authority in such traditional areas as the authority over local service issues, including reliability of local service; administration of integrated resource planning and utility buy-side and demand-side decisions, including DSM; authority over utility generation and resource portfolios; and authority to impose non-bypassable distribution or retail stranded cost charges.

NARUC has requested that the Commission specifically clarify in §35.27 of its proposed rules[545] that nothing in our final rule limits the authority of a state commission "to allow or disallow the inclusion of the costs of electric energy purchased at wholesale in retail rates subject to such State commission jurisdiction." We will adopt NARUC's proposal with modification, but add it as a separate subsection. The Final Rule adopts a new §35.27(b) as follows:

Nothing in this part (i) shall be construed as preempting or affecting any jurisdiction a state commission or other state authority may have under applicable state and federal law, or (ii) limits the authority of a state commission in accordance with state and federal law to establish (a) competitive procedures for the

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acquisition of electric energy, including demand-side management, purchased at wholesale, or (b) non-discriminatory fees for the distribution of such electric energy to retail consumers for purposes established in accordance with state law.

With respect to the Commission's adoption of the Open Access NOPR's functional/technical tests for determining what facilities are Commission-jurisdictional facilities used for transmission in interstate commerce and what facilities are state-jurisdictional local distribution facilities, the case law supports a bright line for unbundled wholesale

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545 Section 35.27 of the proposed rules provided that any public utility seeking authorization to engage in sales for resale at market-based rates shall not be required to demonstrate any lack of market power in generation with respect to sales from capacity first placed in service on or after 30 days from the date of publication of the Final Rule in the *Federal Register*. *FERC Statutes and Regulations* ¶32,514, at p. 33,154.

transmission, *i.e.*, transmission of electric energy that is being sold for resale. This is consistent with the bright line drawn by Congress to fill the *Attleboro* gap for regulating wholesale sales of electric energy. The case law also supports a bright line with respect to retail transmission by intervening utilities, *i.e.*, transmission by those utilities between the new retail generation supplier and the public utility that previously provided bundled retail service to the end user. However, despite many commenters' arguments to the contrary, we cannot divine such a bright line for unbundled retail transmission by the public utility that previously provided bundled retail service to the end user. In fact, the limited case law, including *CL&P* and *Colton*, supports a case-by-case determination.[546] Accordingly, we believe our technical test, with its seven indicators, will permit reasoned factual determinations in individual cases.

Although we are unable to draw the bright line for local distribution facilities that many commenters would like, we believe it is important to make two clarifications regarding local distribution in the context of retail wheeling. First, even when our technical test for local distribution facilities identifies no local distribution facilities for a specific transaction, we believe that states have authority over the *service* of delivering electric energy to end users. Second, through their jurisdiction over retail delivery services, states have authority not only to assess stranded costs but also to assess charges for stranded benefits, such as low-income assistance and demand-side management. Because their authority is over services, not just the facilities, states can assign stranded costs and benefits based on usage (kWh), demand (kW), or any combination or method they find

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[546] As noted, the Commission's detailed legal analysis is contained in Appendix G. We are particularly persuaded by the Supreme Court's statement that whether facilities are used in local distribution is a question of fact to be decided by the Commission as an original matter. *See CL&P*, 515 U.S. at p. 534-35.

appropriate. They do not have to assign them to specific facilities.[547]

Thus, while we believe in most cases there will be identifiable local distribution facilities subject to state jurisdiction, we also believe that even where there are no identifiable local distribution facilities, states nevertheless have jurisdiction in all circumstances over the service of delivering energy to end users. Under this interpretation of state/federal jurisdiction, customers have no incentive to structure a purchase so as to avoid using identifiable local distribution facilities in order to bypass state jurisdiction and thus avoid being assessed charges for stranded costs and benefits.

Based on concerns raised by state commissions as well as some utilities, we have further determined that it is appropriate to provide deference to state commission recommendations regarding certain transmission/local distribution matters that arise when retail wheeling occurs. We also believe it is important to develop mechanisms to avoid regulatory conflict and to help provide certainty to utilities as to which regulator has jurisdiction over which facilities. These are discussed below.

Determining where to draw the jurisdictional line for facilities used in unbundled retail wheeling transactions will involve case-specific determinations that evaluate the seven local distribution indicators that we are adopting. We believe that the Commission should take advantage of state regulatory authorities' knowledge and expertise concerning the facilities of the utilities that they regulate. Therefore, in instances of unbundled

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547 As noted above, states retain authority over state integrated resource planning, utility resource portfolios, and utility buy-side and demand-side decisions.

retail wheeling that occurs as a result of a state retail access program, we will defer to recommendations by state regulatory authorities concerning where to draw the jurisdictional line under the Commission's technical test for local distribution facilities, and how to allocate costs for such facilities to be included in rates, provided that such recommendations are consistent with the essential elements of the Final Rule.[548] Moreover, we recognize that in some cases the Commission's seven technical factors may not be fully dispositive and that states may find other technical factors that may be relevant. We will consider jurisdictional recommendations by states that take into account other technical factors that the state believes are appropriate in light of historical uses of particular facilities.

Some commenters have asked the Commission to provide a forum to prevent or resolve disputes over the correct classification of facilities as transmission or local distribution. As a means of facilitating jurisdictional line-drawing, we will entertain proposals by public utilities, filed under section 205 of the FPA, containing classifications and/or cost allocations for transmission and local distribution facilities. However, as a prerequisite to filing transmission/local distribution facility classifications and/or cost allocations with the Commission, utilities must consult with their state regulatory authorities. If the utility's classifications and/or cost allocations are supported by the state regulatory authorities and are consistent with the principles established in the Final Rule, the Commission will defer to such classifications and/or cost allocations.[549] We

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[548] In order to give such deference, we expect state regulators to specifically evaluate the seven indicators and any other relevant facts and to make recommendations consistent with the essential elements of the Rule.

[549] This should also alleviate some concerns about the potential for costs not being accounted for if the Commission and a state commission use different methods of allocating costs.

encourage public utilities and their state regulatory authorities to attempt to agree to utility-specific classifications and allocations that the utility may file at the Commission.

A number of commenters have asked the Commission to defer to state commission recommendations or decisions regarding rates, terms and conditions of unbundled retail transmission in interstate commerce by public utilities. Some have suggested that we set broad guidelines for such rates, terms, and conditions, and then allow states to actually implement the guidelines. While the Commission cannot simply turn over its jurisdiction for the states to implement, we understand the concerns raised by many state regulators and believe that deference to state commissions with regard to rates, terms, and conditions may be appropriate in some circumstances, as discussed below.

As we determined in the NOPR, when unbundled retail wheeling in interstate commerce occurs, the transaction has two components for jurisdictional purposes—a transmission component and a local distribution component. The Commission has jurisdiction over facilities used for the transmission component of the transaction, and the state has jurisdiction over facilities used for the local distribution component.[550] Thus, the rates, terms and conditions of unbundled retail transmission by a public utility must be filed at the Commission. When this occurs, we will generally expect unbundled retail wheeling customers to take service under the same FERC tariff that applies to wholesale customers. However, if the unbundled retail wheeling occurs as part of a state retail access program, it may be appropriate

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[550] As discussed above, even if there were instances where no local distribution *facilities* are used, we believe states have authority over the *service* of delivering electric energy to end users.

to have a separate retail transmission tariff[551] to accommodate the design and special needs of such programs. In such situations, the Commission will defer to state requests for variations from the FERC wholesale tariff to meet these local concerns, so long as the separate retail tariff is consistent with the Commission's open access policies and comparability principles reflected in the tariff prescribed by this Final Rule. In addition, rates must be consistent with our Transmission Pricing

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Policy Statement, and the guidance herein concerning ancillary services.[552]

A final jurisdictional issue raised in the Open Access NOPR concerns buy-sell transactions. We remain concerned, just as we were with buy-sell arrangements in the gas industry, that buy-sell arrangements can be used by parties to obfuscate the true transactions taking place and thereby allow parties to circumvent Commission regulation of transmission in interstate commerce. Thus, we reaffirm our conclusion that we have jurisdiction over the interstate transmission component of transactions in which an end user arranges for the purchase of generation from a third-party. However, we recognize that there is a wide range of programs and transactions that might or might not fall within this category. We will address these on a case-by-case basis.

In summary, the Commission reaffirms and clarifies its prior jurisdictional conclusions and tests for determining the demarcation between Federal and state jurisdiction over

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551 *I.e.*, the tariff would be different from the tariff that applies to wholesale customers. Such tariff would still be filed with the Commission under FPA section 205.

552 In applying the principles of the Final Rule to retail transmission tariffs, the Commission clearly cannot order retail wheeling directly to an ultimate consumer. *See* FPA section 212(h).

transmission in interstate commerce and local distribution. We have attempted to address these issues in a way that provides for flexibility and recognition of legitimate state concerns. With regard to retail services, we recognize the states' concerns that the unbundling of retail transactions would result in changes from what historically has been regulated by the states (principally, the rates of transmission assets previously included in retail rate base). However, the decision to provide unbundled retail wheeling is not the Commission's to make because we have no authority to order transmission directly to an ultimate consumer. In addition, even if a retail access program occurs, we do not believe the unbundling of retail transactions will radically change fundamental state authorities, including authority to regulate the vast majority of generation asset costs, the siting and maintenance of generation facilities and transmission lines, and decisions regarding retail service territories. Further, the Commission intends to be respectful of state objectives so long as they do not balkanize interstate transmission of power or conflict with our interstate open access policies. As the electric industry and state regulatory authorities continue to develop new competitive market structures and consider retail wheeling programs, we believe that the tests and mechanisms we have provided in this Rule will accommodate both Federal and state interests and will help provide jurisdictional certainty to market participants.

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Appendix C--Allegations of Public Utilities Exercising Transmission Dominance

I. Examples From Proceedings Before Administrative Law Judges

These are examples of allegations that various public utilities have refused to provide comparable service, either through refusals to wheel, dilatory tactics that so protracted negotiations as to effectively deny wheeling, refusals to provide service priority equal to native load, or refusals to provide service flexibility equivalent to the utility's own use.

A. American Electric Power Service Corp. (AEP)

In 1993, AEP filed, on behalf of its public utility associate companies, an open access tariff that offered only firm point-to-point service with very limited flexibility. It did not offer network service, flexible point-to-point service, or non-firm service. Thus, it did not provide customers with the same flexibility that AEP itself has. Nor did it provide a service priority equivalent to that enjoyed by native load. The Commission set AEP's tariff for hearing and, on rehearing, held that in order not to be unduly discriminatory, the tariff had to offer comparable service. American Electric

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Power Service Corp., 64 FERC para. 61,279 (1993), reh'g, 67 FERC para. 61,168 (1994).

At hearing, Raj Rao of Indiana Michigan Power Agency (IMPA) (Ex. IMPA-1, Feb 23, 1994) and Kenneth Hegemann of American Municipal Power-Ohio, Inc. (AMP-Ohio) (Ex. AMPO-1, Feb 23, 1994), both senior management officials, testified concerning AEP's alleged discriminatory practices.[1] AMP-Ohio is an association of municipalities in Ohio, some of whose members depend on AEP for transmission and partial requirements service. IMPA is an association of municipalities in Indiana, and many of IMPA's loads are

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[1] After the Rehearing Order expanding the scope of the proceeding, AMP-Ohio and IMPA withdrew this testimony as no longer necessary. This withdrawal does not change the fact that the testimony was sworn to under oath.

captive to the AEP transmission system. The witnesses alleged as follows:

1. In anticipation of high peak demands, AEP would contract for large blocks of available short-term power, withhold sale of short-term power, refuse to transmit third party short-term power, and require purchases from AEP at the emergency rate (100 mill/kwh) when an emergency might not exist. Ex. AMPO-1 at 6.

2. In December 1989, AMP-Ohio negotiated a 20 MW purchase of short-term power from Louisville Gas & Electric Company (LG&E). AEP refused to wheel because LG&E had earlier that day told AEP it had no power to sell to AEP. AEP then bought the power from LG&E and offered to resell it to AMP-Ohio. Ex. AMPO-1 at 6-7.

3. In January 1990, AMP-Ohio solicited bids for February power purchases from a number of utilities including AEP. AEP was not the winning bid. AMP-Ohio made arrangements to purchase the power from four winning bidders and sought transmission through AEP. When AMP-Ohio gave AEP the schedule for delivery, AEP refused to transmit the power, matched the average price of the winning bids, and made the sale itself. Ex. AMPO-1 at 7.

4. In August 1993, an AMP-Ohio member (Columbus, Ohio) was purchasing 10 MW of hourly non-displacement power from AEP and, after AEP raised its price to 60 mills/kwh, sought another source for the next hour. Consumers Power Company and Detroit Edison Company both offered non-displacement power at 40 mills. AEP refused to transmit, saying it had a 600 MW unit out and could not resell power from another source.[2] Columbus

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[2] AEP generally limited its offer of short-term transmission to buy/sell transactions; that is, AEP would buy the power from the seller and resell it to the purchaser. Supplemental testimony of AEP Witness Baker (Ex. A-73) at p. 27-29. Often, the terms of the buy/sell transaction

cancelled the transaction and had to buy 10 MW of power from AEP at 100 mills/kwh. Ex. AMPO-1 at 7-8.

5. In July 1993, two AMP-Ohio members (Columbus and St. Mary's) had been buying hourly non-displacement power from AEP when the price rose to 35 mills. Dayton Power & Light Company (DP&L) offered to sell at 23 mills and AEP agreed to transmit for one hour. But for the next hour, AEP said it had problems with its system, refused to transmit the power, kept the power from DP&L for itself and offered to sell power to AMP-Ohio for Columbus and St. Mary's at 100 mills. Columbus increased its local generation, but St. Mary's purchased 8 MW at 100 mills. For the next hour, AMP-Ohio arranged with DP&L for another 8 MW, hoping AEP would transmit under the 24 hour buy-sell agreement. AEP did transmit this power. Seven hours later in the day, St. Mary's Greenup Hydro project power was available and the 8 MW from DP&L was no longer needed. If St. Mary's had been receiving the hourly power that AEP had refused to transmit, St. Mary's could have switched to Greenup power. But because AMP-Ohio had changed to daily service, St. Mary's had to pay a demand charge for the entire day, even though it used the power only 7 hours and would have paid less under the hourly rate. Ex. AMPO-1 at 8-9.

6. In January 1994, AMP-Ohio sought to transfer power from one member with generation to other members, which required transmission over AEP and Toledo Edison lines. Toledo Edison said yes, AEP said no. AMP-Ohio's northern members purchased emergency power from Toledo Edison. AMP-Ohio then reminded AEP that it had agreed not to deny transmission

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required transmission dependent utilities (TDUs) to maintain reserves and meet contractual commitments for at least a year. *Id.*

and AEP agreed to transmit. Ex. AMPO-1 at 9.

7. IMPA arranged to buy 80 MW of short-term power from LG&E and have it wheeled, using buy-sell arrangements, through Public Service Company of Indiana (PSI) and AEP to serve IMPA's load at Richmond (an IMPA member). The delivered price was $.292 per kW-day plus a 1 mill adder. At the same time AEP arranged to buy 300 MW from PSI at $.30 per kW day plus out-of-pocket energy costs. Hence, PSI was shipping a total of 380 MW to AEP with 80 MW of that amount to be delivered to IMPA's load at Richmond. Then, on a day when IMPA should have received the 80 MW, AEP told IMPA that PSI had sold everything to AEP and that IMPA would have to buy from AEP at $.63 per kW day plus the cost of energy from AEP. IMPA purchased from AEP under protest. AEP used its control over transmission to intercept the 80 MW at a lower price and resell it as short-term power to IMPA. AEP claimed that PSI had terminated its sales to AEP on that day. But the 80 MW was independent of PSI's other sales to AEP and would not have been interrupted if AEP had not interrupted it. IMPA-1 at 7.

8. IMPA has combustion turbines owned by and located at one member, which IMPA would like to connect to the Joint Transmission System owned by IMPA, CINergy and Wabash Valley Power Association. To do so, IMPA needed a metering agreement with AEP, to which AEP would not agree. IMPA-1 at 6.

9. In January 1994, IMPA had power to sell from its turbines when AEP and others needed power. IMPA offered power to AEP but AEP it said could not purchase the power without an existing contract. Moreover, since there was no short-term tariff, IMPA could not sell the power to another utility. IMPA-1 at 6.

10. Another example of the utility engaging in dilatory tactics that raised the customer's transaction costs and

effectively denied transmission is the "sham transaction" provision proposed by AEP. As filed, AEP's tariffs permitted it to deny service merely because a portion of the transmitted power might be used to serve a former retail customer of AEP. See, e.g., Ex. BR&WVP-1 (J. Bertram Solomon testimony, February 23, 1994). (As part of a settlement AEP filed the pro forma tariff and withdrew this provision.)

11. Finally, AEP's originally filed tariff contained a "prodigal customer" provision. Under this provision, transmission customers who sought to convert back to requirements service had to give AEP five years' notice, in which case AEP and the customer would enter into negotiations to determine whether AEP will provide service at all and if so under what rate, terms, and conditions. Ex. S-39 at 1 (Staff testimony). AEP did not require notice from all new customers, only from prodigal customers. Id. at 2. That a potential customer was previously served by AEP is not a reason to treat the customer differently. (AEP withdrew this provision when it filed the pro forma tariff.)

B. Entergy Services, Inc. (Entergy)

Entergy filed a partial settlement largely adopting the NOPR pro forma tariffs except for two provisions (headroom and ancillary services). Because the settlement predated the filing date for customer testimony before the ALJ, the customers did not address the need for Entergy to file a tariff. However, customers did make allegations of discriminatory practices, as follows.

1. Customers alleged that Entergy flat-out refused to wheel. Louisiana Energy and Power Authority (LEPA) witness Sylvan J. Richard testified that LEPA's predecessor systems could not obtain interconnections from Entergy. Ex. SJR-1 at 50.

2. Customers also alleged that Entergy refused to provide service priority equal to native load and refused to provide service flexibility equivalent to the utility's own use.

For example, LEPA witness Richard testified that even after state commissions ordered interconnections and other coordination services, LEPA's predecessors were still not able to obtain coordination services because Entergy was not willing to coordinate and because the transmission service it did offer was inflexible, unidirectional point-to-point service, which prevented economic coordination with others. Id. at 50-51.

3. South Mississippi Electric Power Association (SMEPA) witness J. Bertram Solomon testified that Entergy's original "open access" tariff was restricted to

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point-to-point service, proposed separate charges for each operating company, and required the cancellation of existing agreements in order to take service under the proposed tariff. Ex. SMEPA-10 at 28. Entergy eventually filed a network tariff, but proposed different local facilities charges for the various Entergy public utility operating subsidiaries. Id. at 29. Since these local facilities charges were higher than the transmission component of the subsidiaries' bundled rates, Entergy obtained a competitive advantage. Id.

4. The Arkansas Cities and Cooperatives (ACC) is a group of cities and cooperatives that own or operate electric generation or distribution systems in Arkansas. ACC Witness Steven Merchant testified that Entergy has segregated the wholesale market between two of its subsidiaries, Arkansas Power & Light Copmpany (APL) and Entergy Power, Inc. (EPI). Ex. SMM-1 at 16. In marketing power and energy in Arkansas, EPI is subject to an Arkansas Commission order that bars EPI from competing with APL for wholesale loads without first obtaining a waiver. Id. Recently, EPI requested this waiver for all wholesale transactions in Arkansas except for wholesale customers currently served by an Entergy subsidiary; in other words, EPI requested the Arkansas Commission to expand competition for all wholesale

customers except where EPI might compete with APL. Id. ACC witness Merchant concluded that, since EPI does not compete with APL, Entergy insulates APL's wholesale business from competition and denies those wholesale customers access to EPI as a source of power, thereby limiting alternative generation sources available to ACC. Id. at 17-19. (Entergy's witness Kenney stated that Entergy has recently filed a joint motion with ACC to the Arkansas Commission seeking to extend the waiver and permit EPI to sell to APL's wholesale customers. Ex. JFK-11 at 14-15.)

C. Pacific Gas & Electric Company (PG&E)

Northern California Power Agency (NCPA) attached several documents to its 1988 complaint in Docket No. EL89-4. These documents were provided to support NCPA's claim that PG&E's unreasonable practices under the PG&E/NCPA Interconnection Agreement (IA) effectively denied NCPA access to transmission properly requested under the IA. Although the parties eventually settled and the Commission terminated the docket with a letter order dated May 18, 1988, these documents provide allegations of PG&E using dilatory tactics that so protracted negotiations as to effectively equal a refusal to wheel.[3]

1. PG&E stated that since transmission was not currently available, it was entitled to wait 72 months before providing transmission; that is, transmission access could not be granted before the passing of the 72-month notice period. NCPA 1988 Complaint, Ex. 3. However, the IA provided that transmission be provided when it becomes actually

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[3] All of these incidents are related to and examples of PG&E's conduct described in the NOPR (*FERC Statutes and Regulations* ¶32,514, at p. 33,073 n.151), that is, the history of PG&E's attempt to avoid its commitments made to the California owners of the California Oregon Transmission Project (COTP). However, these incidents are not exactly the same as the incidents described in the NOPR, because NCPA is not one of the owners of the COTP.

available. PG&E also requested substantial additional information, which NCPA considered beyond that reasonably necessary for a study, but still provided. PG&E then determined that transmission was not available, reasoning that transmission was unavailable unless all the transmission requested could be provided 8760 hours per year without restrictions or limitations, extending through the expiration of the agreement in 2013. NCPA 1988 Complaint at 9.

2. On November 27, 1987, NCPA made a new transmission request to PG&E, seeking 50 MW of bi-directional transmission at Midway. NCPA 1988 Complaint, Ex. 5. On January 28, 1988, PG&E filed an interconnection agreement with Turlock Irrigation District (TID) that provided TID with 50 MW of bi-directional transmission at Midway. Pacific Gas & Electric Company, 42 FERC para. 61,406, order on reh'g, 43 FERC para. 61,403 (1988). On February 22, 1988, PG&E advised NCPA that all firm transmission service available at Midway had

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been fully subscribed. NCPA 1988 Complaint, Ex. 6. Then, on March 29, 1988, PG&E filed with the Commission an interconnection agreement with Modesto Irrigation District (MID), that provided MID with 50 MW of bi-directional transmission at Midway. Pacific Gas & Electric Company, 44 FERC para. 61,010 (1988). At about the same time (in the last week in March 1988), PG&E advised NCPA that the allocations of transmission to TID, MID, and others, including a not yet finalized allocation to Sacramento Municipality Utility District, had used all the transmission available at Midway. NCPA 1988 Complaint, Exs. 7 and 8.

D. Northeast Utilities Service Company (NU)

This is the case where Northeast Utilities acquired Public Service of New Hampshire (PSNH) (Docket No. EC90-10). New England Power Company (NEP) witness Robert Bigelow's direct testimony expressed concern over

the "relatively restrictive transmission policies of both" NU, on behalf of Northeast Utilities' public utility subsidiaries, and PSNH. Bigelow Direct Testimony at 21 (filed May 25, 1990). In his cross rebuttal testimony, Mr. Bigelow testified that "NU has a poor track record as a provider of transmission service" and "PSNH also has an abhorrent track record as a provider of transmission services." Bigelow Cross Rebuttal Testimony, at 3 (filed June 20, 1990). Mr. Bigelow described both NU's and NEP's (his own company) failure to provide service flexibility equivalent to their own use. Except for NEP's TDUs, both NEP and NU historically provided only point-to-point transmission, which required separate scheduling for each transaction. Bigelow Cross Rebuttal at 4.

E. Southern California Edison Company and San Diego Gas and Electric Company

The evidence in this merger proceeding (Docket No. EC89-5) included testimony from a number of witnesses describing instances of Edison's conduct. Richard Greenwalt was the power supply supervisor for the City of Riverside, California. He was responsible for scheduling all purchases of energy for Riverside and for the cities of Azusa, Banning and Colton, California. Greenwalt testimony at 1 (November 1989). (These four cities and Anaheim, California, are collectively referred to as the Southern Cities or Cities.) Joseph Hsu was the Director of Utilities for Azusa. Hsu testimony at 1 (November 1989). Gale Drews was the electric utility director of Colton. Drews testimony at 1-2 (November 1989). Bill Carnahan was the director for Riverside. Carnahan testimony at 1 (November 1989). Gordon Hoyt was the general manager of the Anaheim power department. Hoyt testimony at 1 (November 1989). Dan McCann was the power coordination supervisor for Anaheim. He supervised Anaheim's load scheduling and is a former Edison employee, having worked for Edison for 20 years. McCann Testimony at 1-2 (November 1989). These witnesses testified that Edison refused to wheel as follows.

1. Edison's policy was to curtail the Cities any time it could be justified using any of a list of acceptable reasons to deny interruptible transmission service. Id. at 22-23.

2. Edison would not generally provide transmission service when Edison could save money by itself purchasing the economy energy that would be wheeled. McCann testimony at 19. The Cities called Edison every hour to request interruptible transmission service. Id. Edison often refused to sell energy available in the Western Systems Power Pool to the Cities and then made available higher cost contract energy or partial requirements service. Id. at 19-20.

3. When Anaheim requested Edison provide firm transmission of power from neighboring states, Edison would often agree to provide non-firm service but would not integrate the capacity for many years in the future, saying that its control area did not need capacity at that time. Hoyt testimony at 9. Since the selling utility was interested in a sale of capacity, not just energy, the transaction would not occur. Id. Edison repeatedly used its control over transmission to deny Anaheim access to low-cost firm power. Id. at 9-10.

4. While Edison provided short-term firm transmission service to the Cities, it would only provide long-term firm service for three specific resources: The SONGS nuclear plant, a specific IPP, and Hoover Dam power. Hoyt testimony at 20. One of Edison's reasons for denying long-term transmission was that Edison desired to

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reserve the transmission for its own future (unspecified) needs. Id.

5. In the 1970s, Edison refused to allow the Cities access to the Pacific Intertie. Hoyt testimony at 21; Drews testimony at 7-8.

6. In 1988, Edison refused to provide transmission service for a Cities power purchase from Public Service Company of New Mexico (PSNM) from Palo Verde Nuclear station. Hoyt testimony at 21.

7. Edison has refused to provide requested firm transmission from

--California-Oregon border to Midway Station

--Nevada-Oregon Border to Sylmar Substation

--Palo Verde Switchyard to Vista

--SONGS Switchyard to Vista.

Carahan testimony at 15.

8. Riverside requested transmission from Palo Verde and was told that such service was not available. Carnahan testimony at 16. Edison offered Riverside only 12 MW of curtailable transmission entitlement to provide Riverside's share of Palo Verde. Id. This service was neither large enough or long enough, and Edison insisted on unreasonable terms and conditions. Id.

9. Azusa, Banning and Colton had a contract with Edison that entitled them to use their Palo Verde firm transmission path to schedule energy to meet their contract energy obligation. Edison refused to permit the three cities to use that path. Edison did not contest that the contracts allowed this use, but said that the scheduling of such small amounts of energy for the three cities would be too burdensome. Greenwalt testimony at 14.

10. Edison would not respond in a timely manner to the Cities' requests, routinely taking months to respond. Drews testimony at 15.

11. During the 1980s, Edison provided Colton with some transmission service to allow the Cities to reach certain suppliers, but limited the choices available to the Cities and imposed terms and conditions that increased the Cities' costs

and placed Colton at a disadvantage against Edison. Drews testimony at 9. Arranging alternative generation sources was difficult because the Cities always had to first get Edison to state whether it would provide transmission.

12. During 1988 and 1989, a dispute arose between Edison and the Cities concerning the Hoover Uprating Project. Drews testimony at 16. Edison argued that for the months when units were out of service for uprating, and Southern Cities capacity was reduced to zero, Southern Cities would not receive an energy credit, even though energy was still available and used by Edison. But the contracts allowed a participant who did not have capacity to still schedule its energy as non-firm energy on the capacity of another participant. Id. at 16-17.

13. In 1986, Azusa negotiated a power purchase contract with the California Department of Water Resources in increments of first 5 MW and then 2 MW (for a total of 7 MW). Hsu testimony at 14. First Edison assured Azusa that the transmission for the additional 2 MW would not be a problem. Id. Then Edison would not agree to amend the transmission service agreement for the additional 2 MW. Id.

14. In 1986, Azusa notified Edison of Special Condition 12[4] purchases from PG&E and requested firm transmission service. Id. Two months before service was to begin, Edison notified the Cities of a problem with the transmission lines. Id. Transmission was eventually granted, but only after a four-month delay and substantial losses to the Cities. Id. Then Edison decided there was no problem with its transmission facilities. Id. at 14-15.

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[4] Special Condition 12 of the Integrated Operations Agreement between Edison and the Southern Cities defined certain Special Condition 12 resources and allowed the Cities to make certain uses of those resources, subject to certain restrictions.

15. In 1986-87, the Cities purchased 20 MW from PG&E and 80 MW from Deseret G&T Cooperative. Hoyt testimony at 7-8. Edison stated that without reinforcement of its transmission system, Edison would not provide the transmission. Id. There was a five-month delay during which the Cities were forced to purchase from Edison at a higher cost. Id. at 8-9. Then Edison decided that the transmission system did not need reinforcement. Id. at 8.

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16. Edison also refused to provide a service priority equal to that of native load. It would curtail the Cities in order to purchase more economy energy for itself. McCann testimony at 28. If Edison could make the purchase, it would curtail the City and use the energy for itself. Id. When Edison curtailed the Cities, they were not able to purchase economy energy and instead purchased energy from Edison. Id. at 24.

17. According to Edison, the interruptible transmission it provided the Cities was interruptible for any reason. Id. at 20. A purchase could be terminated the hour after it is begun or even during the hour. Id. As a result, the Cities lost opportunities to make advantageous economy purchases. Id. at 20-21.

18. Edison also refused to provide customers flexibility similar to the flexibility Edison provided itself. Edison's refusal to provide bi-directional transmission service restricted the Cities' abilities to purchase hydroelectric energy from the Pacific Northwest. Hoyt testimony at 22. Because most contracts with Northwest utilities require a return of power, the Northwest utilities would not deal with the Cities without transmission to return energy. Id. at 22-23. Edison did provide bi-directional transmission to the Los Angeles Department of Water & Power (LADWP) to accommodate flows to and from Arizona. Id.

19. Riverside was unable to obtain non-firm service more than two hours in advance of need. Carnahan testimony at 18.

20. Riverside and Colton were both served out of Edison's Vista substation. Although the two cities were on the same 69 kV bus, Edison would not allow them to sell energy to each other. Greenwalt testimony at 17.

21. Riverside's agreement with Edison allowed Riverside to purchase a block of energy through the WSPP and divide it up among the four Cities (Azusa, Banning, Colton and Riverside). Greenwalt testimony at 17. When Riverside had excess energy from other sources, Edison would not permit it to sell that energy to the other three cities. Id. For example, Riverside attempted to sell Deseret energy transmitted by LADWP to the Edison system. Id. at 17-18. LADWP would not break out the Cities' shares of that energy, and Edison would not accept the energy as a delivery for all four cities. Id. at 18. Edison argued that because this energy was excess energy that Riverside could not use, Riverside did not have transmission rights to bring it into the control area. Id. As a result, Riverside paid for the energy delivered by LADWP to the Edison control area, but could not sell it to the other three cities, and gave it to Edison itself, which consumed the energy without making any payment for it. Id. Riverside tried a number of alternative paths, including using WSPP transmission where Riverside paid Edison 5 mills to connect to Azusa, 5 mills to connect to Banning, and 5 mills to connect to Colton for each megawatthour. While this approach was successful for a while, eventually Edison refused to permit these sales.

22. Edison claimed that the Cities only have transmission rights to bring in enough Special Condition 12 energy to satisfy the Cities' load. Greenwalt testimony at 18.

23. Edison contended that the Cities' load requirements were satisfied first by integrated resources and then by

Special Condition 12 and economy energy purchases. Id. at 19. When the Cities' integrated resources exceeded their load, any Special Condition 12 resources became excess. Under Riverside's Deseret contract, the Cities were required to take a minimum of 35 MW each hour. Id. Edison acknowledged that it was obligated to buy, or allow the Cities to sell, any excess energy from Riverside's integrated resources. Id. However, Edisor refused to give the Cities credit for excess Special Condition 12 energy brought into the area, claiming that the Cities could not have brought it in because they did not have transmission rights. Id.

II. Other Examples of Transmission Disputes

Disputes over transmission are not uncommon, contrary to EEI's suggestion. Some recent examples taken from pleadings and other documents and from Commission orders reveal that it has been very difficult for various entities in the electric power industry to agree on transmission rights. These examples also reveal that even after issuance of AEP and the Open Access NOPR with its proposed pro forma tariffs, there has been considerable controversy over whether various utilities'

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"open access" tariffs deviate from those tariffs. (The Commission has allowed utilities that adopt tariffs that match or exceed the non-rate terms and conditions in the NOPR pro forma tariffs to obtain certain benefits.)

A. In a letter of February 3, 1995 to Mr. Gerald Richman of the Commission's Enforcement section in the Office of the General Counsel, Steven J. Kean, Vice President, Regulatory Affairs, Enron Power Marketing, Inc. (Enron) alleged that Niagara Mohawk Power Corporation (NiMo) refused to wheel power from Rochester Gas & Electric (RG&E) to Enron under RG&E's transmission contract with NiMo; however, when Enron revealed the buyer, NiMo did wheel power for RG&E to the buyer. Mr. Kean alleged that this was

not an isolated incident. NiMo argued that the contract did not require it to provide RG&E with transmission to Enron. It also said that the principle of comparability does not require the service. Letter of November 21, 1994 from NiMo representative A. Karen Hill to Gerald Richman.

B. The Commission's Task Force Hot Line (Hot Line) received a complaint that a member of the New York Power Pool (NYPP) refused to transmit power that another member bought from a power marketer. In a letter of November 17, 1994, from Chair Moler to Mr. William J. Balet, Executive Director of NYPP, Chair Moler explained that the Commission's enforcement staff had investigated and found the allegation to be true.

C. In Southern Minnesota Municipal Power Agency v. Northern States Power Company (Minnesota), 73 FERC para. 61,350 (1995), NSP and SMMPA had a contract under which NSP agreed to provide transmission service. However, the parties had numerous disputes over the service. The Commission found that NSP had misinterpreted the contract in several ways. For, example, SMMPA argued that it should be able to directly schedule its deliveries of energy out of the NSP control area and that it should not be limited to particular points of delivery. NSP argued that only it was entitled to control the physical operation of scheduling. The Commission found that the clear language of the contracts gave SMMPA the authority to schedule its owr power.

D. Mid-Continent Area Power Pool, 72 FERC para. 61,223 (1995), involved MAPP's membership criteria, which made it impossible for a power marketer to join MAPP and obtain the benefits of certain transmission services available only to MAPP members. The Commission found that the membership criteria may be unreasonable, particularly since there may be less burdensome ways of setting up membership criteria for non-traditional entities.

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Appendix G

I. Legal Analysis of Commission Jurisdiction Over the Rates, Terms and Conditions of Unbundled Retail Transmission in Interstate Commerce

Based on an analysis of the relevant legislative history and case law under the Federal Power Act (FPA), the Commission concludes that it has exclusive jurisdiction over the rates, terms and conditions of the unbundled transmission in interstate commerce, by a public utility, of electric energy to an end user. This is also known as retail wheeling in interstate commerce.[1]

The Commission's jurisdiction over the rates, terms and conditions of transmission in interstate commerce derives from Congress' power to regulate interstate commerce under the United States Constitution[2] and the FPA. When Congress enacted the FPA, it gave the Commission exclusive jurisdiction over the rates, terms and conditions of transmission in interstate commerce by public utilities. The Supremacy Clause of the Constitution provides that federal laws enacted pursuant to the powers delegated to the federal government by the United States Constitution are the supreme law of the land.[3] Accordingly, to the extent that retail wheeling involves transmission in interstate commerce

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1 Section 212(h) of the FPA provides that no order issued under the FPA shall be conditioned upon or require the transmission of electric energy directly to an ultimate consumer. 16 U.S.C. §824k(h). The Commission's assertion of jurisdiction in this final rule is over the rates, terms and conditions of retail transmission that occurs voluntarily or as a result of a state retail access program.

2 U.S. Const. art I, Section 8, cl.3.

3 U.S. Const. art. VI, cl.2.

by public utilities, the rates, terms and conditions of such service are subject to the exclusive jurisdiction of the Commission, and must be filed with the Commission.[4]

1. Relevant Federal Power Act Provisions

Section 201(b)(1) of the FPA provides:

The provisions of this Part shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce * * *. The Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction * * * over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter.

16 U.S.C. 824(b)(1) (emphasis added). Thus, the statute on its face limits Commission jurisdiction over sales of energy to sales at wholesale, but does not limit jurisdiction

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over transmission to transmission used only for wholesale sales.

Sections 201(c) and (d) define the meaning of "the transmission of electric energy in interstate commerce" and "sale of electric energy at wholesale in interstate commerce." Section 201(c) provides:

For the purpose of this Part, electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof; but only insofar as such transmission takes place within the United States.

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[4] *See Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246, 251-52 (1951) (*Montana-Dakota*).

16 U.S.C. 824(c). Section 201(d) provides:

The term "sale of electric energy at wholesale" when used in this Part means a sale of electric energy to any person for resale.

16 U.S.C. 824(d).

Sections 205 and 206 of the FPA give the Commission jurisdiction over the rates, terms and conditions of transmission in interstate commerce, and sales at wholesale in interstate commerce, by public utilities. 16 U.S.C. 824d and 824e.

2. Legislative History and Case Law

Much of the legislative history of the FPA indicates that Congress intended the Commission's jurisdiction to extend only to those matters which the Attleboro decision[5] held to be beyond the reach of the States. For instance, the report accompanying the Senate bill states that subsection (b) "leaves to the States the authority to fix local rates even in cases where the energy is brought in from another State."[6] In other words, states retain authority to regulate rates of electric energy to ultimate consumers. The Senate report also states:

The rate-making powers of the Commission are confined to those wholesale transactions which the Supreme Court held in (Attleboro) to be beyond the reach of the States. Jurisdiction is asserted also over all interstate transmission lines whether or not there is sale of the energy carried by

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5 *Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927) (Attleboro). In Attleboro, the Supreme Court held that State regulation of the interstate sale of electricity was barred by the Commerce Clause because such regulation would impose a "direct burden" on interstate commerce.

6 S. Rep. No. 621, 74th Cong., 1st Sess. 48 (1935). See also H.R. Rep. No. 1318, 74th Cong., 1st Sess. 8 (1935).

those lines and over the generating facilities which produce energy[7] for interstate transmission and sale.

S. Rep. No. 621, 74th Cong., 1st Sess. 48 (1935) (emphasis added). Thus, federal jurisdiction over transmission lines is not dependent on whether those lines are used to effect a sale, wholesale or otherwise.

The provisions of FPA section 201 reserving certain regulatory authority to the States have been interpreted narrowly.[8] The Supreme Court has stated:

In section 201(b), Congress did no more than leave standing whatever valid state laws then existed relating to the exportation of hydroelectric energy; by its plain terms, section 201(b) simply saves from pre-emption under Part II of the Federal Power Act such state authority as was otherwise "lawful."[9]

The Court also stated:

Nothing in the legislative history or language of the statute evinces a congressional intent 'to alter the limits of state power otherwise imposed by the Commerce Clause,' *

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7 The provisions of the Senate bill regarding federal jurisdiction over generating facilities were eliminated from the final version of the bill.

8 Section 201(a) declares that Federal regulation of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, "such Federal regulation, howe.er, to extend only to those matters which are not subject to regulation by the States." 16 U.S.C. §824(a). Section 201(b)(1) states that the provisions of Part II of the FPA apply to the transmission of electric energy in interstate commerce and the sale of electric energy at wholesale in interstate commerce but, except as specifically provided, "shall not apply to any other sale of electric energy or deprive a State or State commission of its lawful authority now exercised over the exportation of hydroelectric energy which is transmitted across a State line." 16 U.S.C. §824(b)(1).

9 *New England Power Co. v. New Hampshire*, 455 U.S. 331, 341 (1982) (NEPCO).

* * or to modify the earlier holding of this Court concerning the limits of state authority to restrain interstate trade.[10]

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Unlike the narrow interpretations given to the FPA provisions reserving certain regulatory authority to the States,[11] the courts have construed transmission "in interstate commerce" broadly. The term does not turn on whether the contract path for a particular power or transmission sale crosses state lines, but rather follows the physical flow of electricity. Because of the highly integrated nature of the electric system, this results in most transmission of electric energy being "in interstate commerce."

One of the earliest cases construing Commission jurisdiction over transmission was Jersey Central Power & Light Co. v. FPC, 319 U.S. 61 (1943) (Jersey Central). In that case, the Commission asserted jurisdiction over a New Jersey utility by showing that the utility owned transmission facilities that were used to transmit energy in interstate commerce. The Court found that the Commission had demonstrated that the utility owned transmission facilities that were indirectly interconnected, through a second New Jersey utility, to facilities owned by a New York utility and that the facilities were used to transmit electric energy in interstate commerce.

The Court noted that section 201(c) of the FPA defines electric energy transmitted in interstate commerce to be

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10 *Id.* (citation omitted).

11 While Congress may exercise its Commerce Clause authority to grant the States that "ability to restrict the flow of interstate commerce that they would not otherwise enjoy," Lewis v. BT Investment Managers, Inc., 447 U.S. 27, 44 (1980), States may not exercise such regulatory powers unless Congress has expressly stated its intention to make such an affirmative grant of power. *NEPCO*, 455 U.S. at p. 343.

energy "transmitted from a State and consumed at any point outside thereof." The Court stated:

> It is impossible for us to conclude that this definition [of transmission in interstate commerce] means less than it says and applies only to the energy at the instant it crosses the state line and so only to the facilities which cross the line and only to the company which owns the facilities that cross the line.

319 U.S. at 71. Thus, a critical question regarding the jurisdictional status of a wheeling transaction is whether the facilities used to provide the service transmit electric energy in interstate commerce.

In Connecticut Light & Power Co. v. FPC, 324 U.S. 515 (1945) (CL&P), the Court reviewed the Commission's finding that a Connecticut utility was jurisdictional because it owned transmission facilities that were used in interstate commerce. The Court generally embraced the Jersey Central standard for determining whether facilities are used to transmit electric energy in interstate commerce. The Court emphasized that whether certain facilities transmit electric energy in interstate commerce is more a technical than a legal question. The Court stated:

> Federal jurisdiction was to follow the flow of electric energy, an engineering and scientific, rather than a legalistic or governmental, test.

324 U.S. at 529. Thus, the Court adopted the Jersey Central test providing that the Commission's jurisdiction generally extends to transmission facilities that transmit electric energy in interstate commerce.

The Court also applied the Jersey Central test in FPC v. Florida Power & Light Co., 404 U.S. 453 (1972), affirming the Commission's finding of jurisdiction over a Florida utility. The Commission demonstrated that the utility

transmitted power to another Florida utility's "bus"[12] and that power was simultaneously transferred from the "bus" to a Georgia utility. The Court upheld the Commission's finding that electric energy from the two Florida utilities was commingled and was therefore transmitted in interstate commerce. 404 U.S. at 463.

In all of the above cases, the Court's decisions turned on whether energy being transmitted flowed in interstate commerce as a technical matter. The decisions did not turn on whether the transmission of energy flowing in interstate commerce involved energy that was being sold for resale or was being sold to

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an end user. Thus, there is nothing in the statute, its legislative history, or the case law to indicate that the Commission's jurisdiction over rates, terms and conditions of transmission in interstate commerce extends only to wholesale transmission and not retail transmission. Indeed, the statute on its face gives the Commission jurisdiction over transmission in interstate commerce and makes no distinction between wholesale transmission and retail transmission.

However, there are two important limitations on Commission authority. First, as discussed above, the FPA does not give the Commission jurisdiction over sales of electric energy at retail. Such sales historically have been bundled sales (i.e., generation and transmission), and courts and the Commission have recognized State jurisdiction over bundled sales of energy. Second, under section 201(b)(1) of the FPA, the Commission does not have jurisdiction over facilities used in local distribution. In CL&P, the Court stated

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[12] A bus is an electrical conductor which serves as a common connection for two or more electrical circuits. Electric Utility Rate Design Study, Glossary: Electric Utility and Ratemaking Load & Management Terms, Edison Electric Institute (Sept. 11, 1978).

that local distribution facilities are exempt from Commission jurisdiction even if those facilities "carry no energy except extra-state energy." 324 U.S. at 531.

In the next section the Commission further discusses the statutory provisions and case law that shed light on the demarcation between transmission and local distribution, and thus on the jurisdictional line between federal and State authority.

II. Legal Analysis of Commission Jurisdictional Transmission Facilities and State Jurisdictional Local Distribution Facilities

Two specific circumstances are addressed:

First, what facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to a purchaser who will then re-sell the energy to an end user?

Second, what facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to an end user?

Based on an analysis of the relevant legislative history and case law under the FPA, the Commission reaches the following conclusions. With respect to the first circumstance, the Commission concludes that a public utility's facilities used to deliver electric energy to a wholesale purchaser, whether labeled "transmission," "distribution," or "local distribution" are subject to the Commission's exclusive jurisdiction under sections 205 and 206 of the FPA, and that a public utility's facilities used to deliver electric energy from the wholesale purchaser to the ultimate consumer are

"local distribution" facilities subject to the rate jurisdiction of the state.[13]

With respect to the second circumstance, the Commission believes that, based on the particular facts of the case, some of the public utility's facilities used to deliver electric energy to an end-user may be FERC-jurisdictional transmission facilities, while some of the facilities used may be state-jurisdictional local distribution facilities.

We set forth below the relevant legislative history and case law, our legal conclusions, and the factors which we believe are indicative of whether facilities are used in "local distribution" or "transmission in interstate commerce," as those terms are used in the FPA.

1. Relevant Federal Power Act Provisions

The Commission's jurisdiction is set forth in section 201 of the FPA.[14] Section 201(b)(1) provides in pertinent part:

The provisions of this Part shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce * * *. The Commission shall have jurisdiction over all facilities for

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such transmission or sale of electric energy, but shall not have jurisdiction * * * over facilities used in local distribution or only for the transmission of electric energy in

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[13] There are, of course, facilities that are used to provide delivery to both wholesale purchasers and end users. In those situations, we believe that the Commission and the States have jurisdiction to set rates for the services that are within their respective jurisdictions. That facilities are used to serve resale and retail customers does not, however, necessarily mean that the facilities are local distribution facilities.

[14] 16 U.S.C. §824.

intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter.[15]

Some of the court decisions that construe jurisdictional facilities under section 201 also construe the Commission's jurisdiction under section 203. Section 203(a) provides, in relevant part:

No public utility shall sell, lease, or otherwise dispose of the whole of its facilities subject to the jurisdiction of the Commission, * * * or by any means whatsoever, directly or indirectly, merge or consolidate such facilities or any part thereof with those of any other person * * * without first having secured an order of the Commission to do so.[16]

In addition, section 206(d) concerns facilities "under the jurisdiction of the Commission":

The Commission upon its own motion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.[17]

2. Legislative History of the FPA

The relevant legislative history of the general purposes of Title II of the FPA, and of section 201 in particular, focuses primarily on bundled sales of electric energy and does not directly address the issue of what constitutes local distribution as opposed to transmission in interstate commerce.

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15 16 U.S.C. §824(b) (emphasis added).

16 16 U.S.C. §824b (emphasis added).

17 16 U.S.C. §824e(d) (emphasis added).

In discussing the general purposes of Title II of the House bill, the House Report states:

Title II * * * establishes for the first time regulation of electric utility companies transmitting energy in interstate commerce.

* * * * *

* * * Under the decision of the Supreme Court of the United States in (Attleboro), the rates charged in interstate wholesale transactions may not be regulated by the States. Part II gives the Federal Power Commission jurisdiction to regulate these rates. A "wholesale" transaction is defined to mean the sale of electric energy for resale and the Commission is given no jurisdiction over local rates even where the electric energy moves in interstate commerce.[18]

In its analysis of section 201, the House Report states:

As in the Senate bill no jurisdiction is given over local distribution of electric energy, and the authority of States to fix local rates is not disturbed even in those cases where the energy is brought in from another State.[19]

The Senate Report's discussion of the general purposes of the FPA states:

The decision of the Supreme Court in (Attleboro) placed the interstate wholesale transactions of the electric utilities entirely beyond the reach of the States. Other features of this interstate utility business are equally immune from State control either legally or practically.[20]

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[18] H.R. Rep. No. 1318, 74th Cong., 1st Sess. 7-8 (1935).

[19] *Id.* at p. 27.

[20] S. Rep. No. 621, 74th Cong., 1st Sess. at p. 17 (1935). See *id.* at p. 18 ("The revision [between the original and final versions of the Senate bill] has also removed every encroachment upon the authority of the

In discussing material differences between the final version of the Senate bill and the original version, the Senate Report states:

Subsection (b), formerly (a), which states the subject matter to which the part relates, has been clarified to make plain that it includes interstate transmission where there is no sale and excludes

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all facilities used only for production of transmission in intrastate commerce or in local distribution.[21]

In discussing section 201 of the Senate bill, the Senate Report further states:

The rate-making powers of the Commission are confined to those wholesale transactions which the Supreme Court held in (Attleboro) to be beyond the reach of the States. Jurisdiction is asserted also over all interstate transmission lines whether or not there is sale of the energy carried by those lines and over the generating facilities which produce energy for interstate transmission and sale. It is obvious that no steps can be taken to secure the planned coordination of this industry on a regional scale unless all of the facilities, other than those used solely for retail distribution, are made subject to the jurisdiction of the Commission. Facilities used only for intrastate commerce or local distribution are expressly excluded from the operation of the act.[22]

States. The revised bill would impose Federal regulation only over those matters which cannot effectively be controlled by the States.")

21 *Id.* at p. 19.

22 *Id.* at p. 48. The provisions of the Senate bill regarding federal jurisdiction over generating facilities were eliminated from the final version of the bill.

The Conference Report adds little description regarding jurisdictional facilities. In reference to section 201(b) it states that:

[T]he language of the House amendment has been followed with a clarifying phrase added to remove any doubt as to the Commission's jurisdiction over facilities used for the generation and local distribution of electric energy to the extent provided in other sections of this part and the part next following.[23]

In addition to the above statements pertaining to section 201 of the FPA, Congress referenced distribution of energy in the legislative history of section 206(d). Section 206(d) was originally enacted as section 206(b) of the FPA. Under the Regulatory Fairness Act of 1988,[24] section 206(b) was redesignated as section 206(d).

The Conference Report on the original FPA does not address section 206(b). The Senate Report on the FPA bill states in pertinent part:

Subsection (b) authorizes the Commission to investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy. * * * Since the rate-making powers granted to the Commission apply only to the wholesale rates of energy sold in interstate commerce, this last subsection should be of great benefit in removing the practical difficulty which the States may encounter in regulating the interstate distribution rates which are left under their control. Such rate regulation involves the examination and valuation of property outside the State. The task is one requiring an agency with a

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23 H.R. Conf. Rep. No. 1903, 74th Cong., 1st Sess. 74 (1935).

24 Pub. L. No. 100-473, 102 Stat. 2299 (1988).

jurisdiction broader than that of a single State. The authority of the Federal Commission is to render assistance to the State commissions in a way which would preserve and make more effective the jurisdiction which is thus left to the States.[25]

The House Report discusses section 206(b) as follows:

This subsection reaches those situations where electric energy is transmitted in interstate commerce by the same company which distributes it locally, and will greatly aid State commissions in fixing reasonable rates in such cases.[26]

Thus, the discussions in the two reports do not appear to contemplate a situation in which the transmitter and seller of electric energy are different, and neither is a "local" distributor. The House Report expressly refers to the same company being the transmitter and seller of electric energy. The Senate Report by its terms addresses the regulation of interstate distribution rates.[27]

The above legislative history on sections 201 and 206(b) does not provide any

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definitive answers to the questions raised. We therefore turn to the case law under the FPA.

3. Case Law Under the FPA

Jersey Central was the first of the major FPC jurisdictional cases considered by the Supreme Court. The

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[25] S. Rep. No. 621, 74th Cong., 1st Sess. 51 (1935) (emphasis added).

[26] H.R. Rep. No. 1318, 74th Cong., 1st Sess. 29 (1935) (emphasis added).

[27] The Senate Report states that interstate distribution rates are left in the States' control. Obviously, the Senate drew a distinction between interstate distribution (left in the States' control) and interstate transmission (given to the FPC). Compare S. Rep. No. 621 at p. 49 with H.R. Rep. No. 1318 at p. 51.

case involved the acquisition by New Jersey Power and Light Company (New Jersey Power) of certain securities of Jersey Central Power & Light Company (Jersey Central) without the Commission's prior approval. The question before the Court was whether Jersey Central was a "public utility" under section 201(e)[28] of the FPA so that the Commission's prior approval of the stock acquisition was necessary under section 203 of the FPA.

Jersey Central owned transmission facilities that connected to facilities that Public Service Electric & Gas Company (Public Service) owned. The interconnection of these transmission facilities was in New Jersey. Public Service's facilities in turn connected to the facilities of the Staten Island Edison Corporation (Staten Island Edison), a New York utility, at the mid-channel of Kill van Kull, a body of water separating New Jersey and New York. Jersey Central delivered energy to and received energy from Public Service under contract, and Public Service delivered energy to and received energy from Staten Island Edison under contract.[29]

The Court found that, although Jersey Central generated and received electricity only in New Jersey, some of the electric energy that it dispatched to Public Service "was instantaneously transmitted to New York."[30] The Court held that "[t]his evidence * * * furnishes substantial basis for the conclusion of the Commission that facilities of Jersey Central are utilized for the transmission of electric energy across

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28 Section 201(e) defines a "public utility" as "any person who owns or operates facilities subject to the jurisdiction under this Part (other than facilities subject to such jurisdiction solely by reason of section 210, 211, or 212)." 16 U.S.C. §824(e). The section as adopted in 1935 did not contain the parenthetical, which was adopted in 1978 as part of the Public Utility Regulatory Policies Act.

29 Jersey Central, 319 U.S. at pp. 63-65.

30 *Id.* at p. 66.

state lines."[31] Therefore, the Court found that Jersey Central was a public utility within the meaning of section 201(e).[32]

The Court cited Attleboro, in which the Court found that the sale of locally produced electric energy for use in another state resulted in the transmission of electric energy in interstate commerce, even though title passed at the state line.[33] In Jersey Central, the Court explained the rationale for federal jurisdiction as follows:

(Section 201(c) of the FPA) defines the electric energy in commerce as that "transmitted from a State and consumed at any point outside thereof." There was no change in this definition in the various drafts of the bill. The definition was used to "lend precision to the scope of the bill." It is impossible for us to conclude that this definition means less than it says * * *. The purpose of this act was primarily to regulate the rates and charges of the interstate energy.[34]

The Court in Jersey Central thus interpreted the FPA as placing within the federal province regulation of wholesale sales of electric energy that, in any manner, flows in interstate commerce. The language quoted above and the citation to section 201(c) of the FPA, to be relied upon in subsequent Supreme Court cases, strongly suggested that the Commission's jurisdiction was not based on whether there was a sale by the utility, but rather on the flow of electric energy either into or out of a state, so long as the energy crosses state lines.

CL&P, which was decided two years after Jersey Central, is the leading case interpreting the section 201(b) local distribution proviso. In CL&P, the Commission sought

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31 *Id.* at p. 67 (citation omitted).

32 *Id.* at p. 73.

33 273 U.S. at pp. 86, 89-90.

34 319 U.S. at p. 71 (footnote omitted).

to regulate the accounting practices of Connecticut Light & Power Company (CL&P).[35] At issue was whether

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CL&P was a "public utility" under the FPA. The utility's system encompassed an area solely within a single state (Connecticut)[36] and did not interconnect with any other company that operated out of state.[37] "Its purchases and sales, its receipts and deliveries of power, (were) all within the state."[38] However, CL&P did purchase energy from companies that had, in turn, purchased energy from Massachusetts. The company also sold energy to a municipality that exported a portion of that energy to Fishers Island, located off the coast of Connecticut but "territory of New York."[39] The Commission based its jurisdiction on these few transactions.[40]

The Court of Appeals affirmed the Commission, holding that the Commission's jurisdiction extended to "electric distribution systems which normally would operate as interstate businesses." The Court of Appeals found that:

Whether or not the facilities by which petitioner distributes energy from Massachusetts should be classified as 'local' is not relevant to this case. The sole test of jurisdiction of the Commission over accounts is whether these facilities,

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35 CL&P, 324 U.S. at p. 517.

36 *Id.* at p. 518.

37 *Id.* at p. 521.

38 *Id.* at p. 522.

39 *Id.* at pp. 519-21.

40 *Id.*

'local' or otherwise, are used for the transmission of electric energy from a point in one state to a point in another.([41])

The Supreme Court reversed. It held that the statutory language in section 201(b) of the FPA providing that the Commission "shall not have jurisdiction * * * over facilities used in local distribution" is a limitation upon Commission jurisdiction that "the Commission must observe and the courts must enforce."[42] In analyzing the statute, the Court stated:

It has never been questioned that technologically generation, transmission, distribution and consumption are so fused and interdependent that the whole enterprise is within the reach of the commerce power of Congress, either on the basis that it is, or that it affects, interstate commerce, if at any point it crosses a state line.

* * * *

But whatever reason or combination of reasons led Congress to put the provision in the Act, we think it meant what it said by the words "but shall not have jurisdiction * * * over facilities used in local distribution." Congress by these terms plainly was trying to reconcile the claims of federal and local authorities and to apportion federal and state jurisdiction over the industry.[43]

The Court decided that this limitation on jurisdiction was "a legal standard that must be given effect in this case in addition to the technological transmission test."[44]

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41 *Id.* at p. 522, *quoting Connecticut Light & Power Co. v. FPC*, 141 F.2d 14, 18 (D.C. Cir. 1944).

42 324 U.S. at p. 529.

43 *Id.* at pp. 529-31.

44 *Id.* at p. 531.

The Court stated that whether or not local distribution facilities carried out-of-state electric energy was irrelevant. Whatever the origin of the electric energy they carried, so long as the utility used the lines for local distribution,[45] they were exempt from federal jurisdiction.[46] In fact, the Court stated that local distribution facilities "may carry no energy except extra-state energy and still be exempt under the Act." Id. at 531. The Court concluded that the Commission's order:

Must stand or fall on whether this company owned facilities that were used in transmission of interstate power and which were not facilities used in local distribution.[47]

Upon reversing the Court of Appeals, the Court commented, in dictum, on the evidence the Commission had relied upon in finding that the facilities in question were used for transmission. It noted that the Commission had relied upon certain gas transportation cases in concluding that transmission extends from the generator to the point where the function of conveyance in bulk over distance is completed

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and the process of subdividing the energy to serve ultimate consumers, which is the characteristic of "local distribution," is begun. The Court cautioned:

But a holding that distributing gas at low pressure to consumers is a local business is not a holding that the process of reducing it from high to low pressure is not also part of such local business. In so far as the Commission found in these cases a rule of law which excluded from the business of local distribution the process of reducing energy from high to

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[45] It appears that while the Company received power (at one location) at 66 kV, it primarily owned facilities at 13.8 kV and below.

[46] 324 U.S. at p. 531.

[47] *Id.* at p. 531 (emphasis added).

low voltage in subdividing it to serve ultimate consumers, the Commission has misread the decisions of this Court. No such rule of law has been laid down.[48]

The Court also noted in its dictum, however, that once a company is properly found to be a "public utility" under the Act, the fact that a local commission may also have jurisdiction does not preclude exercise of the Commission's functions. Id. at 533.[49] The Court instructed the lower court to remand the case to the Commission for a finding regarding whether the facilities in question were used in local distribution.[50]

The CL&P case was ultimately disposed of without the Commission having made a finding that the facilities were used in local distribution. While the Commission found that it was "extremely doubtful" that it could find that the facilities in question were not local distribution facilities, 6 FPC 104, 106 (1947), the Commission did not articulate a definition of local distribution facilities.

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48 *Id.* at p. 534.

49 *See United States v. Public Utilities Commission of California*, 345 U.S. 295, 316 (1953) (Public Utilities Commission): Certainly the concrete fact of resale of some portion of the electricity transmitted from a state to a point outside thereof invokes federal jurisdiction at the outset, despite the fact that the power thus used traveled along its interstate route "commingled" with other power sold by the same seller and eventually directly consumed by the same purchaser-distributor.

See also Arkansas Power & Light Co. v. FPC, 368 F.2d 376, 383 (8th Cir. 1966) ("Where a company is in fact a public utility, all wholesale sales for resale in interstate commerce are subject to the provisions of sections 205 and 206 of the (FPA), regardless of the facilities used."). The Eighth Circuit further noted that the section 201(b) exemption applies to a company's status as a public utility and not to the Commission's jurisdiction over sales in interstate commerce for resale. *Id., citing Public Utilities Commission, Colton, infra* and *Wisconsin-Michigan, infra.*

50 *Id.* at p. 536.

In Wisconsin-Michigan Power Co. v. Federal Power Commission,[51] the Seventh Circuit held that a utility was a jurisdictional public utility where it operated two divisions in Wisconsin and Michigan in a coordinated manner such that electric energy from one state was transmitted to the other, and vice versa, "in appreciable amounts by the power company and by it commingled with energy generated in the two respective districts and then delivered to the [wholesale] customers * * *."[52] The court also rejected the notion that the energy changed its form or character when it was stepped down in voltage before it reached the wholesale purchasers.[53]

The court in Wisconsin-Michigan distinguished between transmission and local distribution by focusing on wholesale sales of electric energy versus retail sales ("local rates") of electric energy. It cited the House Report on the FPA, and characterized the legislative history as follows:

The legislative history, (H.R. Rep. No. 1318), 74th Cong., 1st Sess. pages 7, 8 and 27 (1935), discloses that the Congressional Committee intended that the provisions of the (FPA) should apply to the transmission of electric energy in interstate commerce, i.e., the sale of energy at wholesale in interstate commerce, but not to the retail sale of any such energy in local distribution; that the (FPA) left to the state the authority to fix local rates where the energy is brought in from other states, and that the rate making power of the (FPC) was to be confined to those wholesale transmissions which the Supreme Court had held in (Attleboro) to be

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51 197 F.2d 472 (7th Cir. 1952), cert. denied, 345 U.S. 934 (1953) (*Wisconsin-Michigan*).

52 *Id.* at p. 474.

53 *Id.* ("Obviously the energy thus transmitted in interstate commerce is not changed in form or in character except that the voltage is reduced to an extent consistent with efficient economic management and operation.").

beyond the reach of the state. Under that decision, said the committee, the rates

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charged in interstate wholesale transactions could not be regulated by the states. It defined a wholesale transaction as the sale of electric energy for resale.[54]

The Seventh Circuit's characterization of the House Report seems to equate transmission of electric energy in interstate commerce with the sale of energy at wholesale in interstate commerce. However, this interpretation is at odds with both the plain words of the statute as well as the language of the House Report, both of which refer to transmission in interstate commerce separately from sales for resale in interstate commerce.[55] In addition, the Senate Report, which the Seventh Circuit did not mention, clearly recognized jurisdiction over all interstate transmission lines, whether or not a sale of energy is carried by those lines.[56]

The Wisconsin-Michigan court also cited analogous natural gas cases, stating that "[t]he question is essentially, when does interstate commerce transportation end and where do the local distribution facilities first become operative."[57] The court further stated that:

(U)pon delivery to (the wholesaler) local distribution begins when he resells. His sales and distribution at retail are

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54 197 F.2d at p. 476 (emphasis added).

55 See H.R. Rep. No. 1318 at p. 27. ("Subsection (b) confers jurisdiction upon the Commission over the transmission of electric energy in interstate commerce and the sale of electric energy in wholesale in interstate commerce * * *." emphasis added).

56 See S. Rep. No. 621 at p. 48 ("Jurisdiction is asserted over all interstate transmission lines whether or not there is a sale of the energy carried by those lines * * *.").

57 197 F.2d at p. 477.

clearly local in character, and constitute only local distribution; but at no point before delivery to him has been completed, has interstate transmission terminated. In other words, "facilities used in local distribution" means facilities used for making resale and distribution to consumers, jurisdiction over which is left to the states. It was only because of this conclusion that the Supreme Court said, (citation omitted), the Act "cut(s) sharply and cleanly between sales for resale and direct sales for consumptive uses." We think there is no ground for the position that local distribution includes any transmission occurring before the wholesaler who resells at retail is reached.[58]

The Seventh Circuit concluded that the sales for resale were made in interstate commerce; that local distribution had not begun; that the interstate character of the transmission persisted until delivery to the wholesaler; that, up to that point, no local distribution facilities were in operation and that, therefore, the sales were subject to Commission regulation.

In Federal Power Commission v. Southern California Edison Company (the Colton case),[59] the Supreme Court held that the FPA provides a clear line of demarcation between jurisdictional transactions and non-jurisdictional transactions. However, this case, too, involved bundled sales of electric energy. In the facts of the case, Southern California Edison Company (Edison) admitted that it was a public utility by virtue of owning two interstate transmission lines.[60] At issue was whether its sales of electric energy to the City of Colton,

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58 *Id., citing FPC v. East Ohio Gas Co.*, 338 U.S. 464 (1950) (East Ohio).

59 376 U.S. 205 (1964) (Colton).

60 The Supreme Court noted that Edison's status as a public utility did not decide the question of whether the FPC could assert jurisdiction over the rates for the Edison-Colton sale. Id. at p. 208 n.3.

California, for resale to Colton's retail customers, were jurisdictional. Included in the electric energy that Edison sold to Colton was out-of-state electric energy from Hoover Dam.[61] The Commission ruled that the sale to Colton was a sale of electric energy at wholesale in interstate commerce subject to regulation under the FPA.[62] In upholding the Commission, the Court held that Edison's importation of out-of-state electricity for resale to Colton sufficed to confer federal jurisdiction.

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The Court, citing an earlier Supreme Court case,[63] characterized Congressional intent in the FPA:

(W)hat Congress did was to adopt the test developed in the Attleboro line which denied state power to regulate a sale "at wholesale to local distributing companies" and allowed state regulation of a sale at "local retail rates to ultimate consumers."[64]

The Court rejected the argument that FPC jurisdiction was confined to those interstate wholesale sales constitutionally beyond the power of state regulation by force of the Commerce Clause, and was to be determined on a case-by-case analysis of the impact of state regulation upon the national interest. The Court stated that in the FPA:

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61 *Id.* at p. 208, 209 & n.5.

62 *Id.* at p. 208. *See Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375, 380 (1983) ("(Colton) held, among other things, that * * * a California utility that received some of its power from out-of-state was subject to federal and not state regulation in its sales of electricity to a California municipality that resold the bulk of the power to others.").

63 *Illinois Natural Gas Co. v. Central Illinois Public Service Co.*, 314 U.S. 498, 504 (1942).

64 376 U.S. at p. 214.

(C)ongress meant to draw a bright-line easily ascertained, between state and federal jurisdiction, making unnecessary such case-by-case analysis. This was done in the Power Act by making FPC jurisdiction plenary and extend[ed] it to all wholesale sales in interstate commerce except those which Congress has made explicitly subject to regulation by the States.[65]

The Court held that "(t)here is no such exception covering the Edison-Colton sale."[66]

Parties in the Colton case had raised the question of whether jurisdiction over the Colton sale was prevented by the "local distribution" proviso of section 201(b). The Court stated that whether facilities are local distribution facilities is a matter for the Commission to decide in the first instance. Citing CL&P, supra, it stated:

Whether facilities are used in local distribution—although a limitation on FPC jurisdiction and a legal standard that must be given effect in addition to the technological transmission test * * *—involves a question of fact to be decided by the FPC as an original matter.[67]

The Court cited evidentiary support and the Commission's expertise in such matters in upholding the Commission's determination that certain facilities owned by Edison were used exclusively to effect the wholesale sale to Colton and not for local distribution. Such facilities included 12 kV lines that served an industrial customer, several lighted highway signs, a residence and a railroad section house before they reached the transformers in the Colton substation. The FPC had held that those uses prior to the lines reaching

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65 *Id.* at pp. 215-216.

66 *Id.* at p. 216 (footnote omitted).

67 *Id.* at p. 210 n.6 (citation omitted).

the Colton substation did not transform the lines into local distribution facilities.[68]

In Duke Power Company v. Federal Power Commission (Duke),[69] the D.C. Circuit held that a public utility's acquisition of facilities used solely in local distribution, and which would continue to be used for local distribution, was beyond the Commission's jurisdiction under section 203. The case involved Duke Power Company's (Duke's) proposed acquisition of facilities owned by Clemson University (Clemson), which were used to distribute electricity off-campus to customers (primarily university personnel) in two South Carolina counties. Clemson purchased the power at wholesale from Duke. No one appeared to contest the conclusion that the 7 miles of distribution line and 418 service connections owned by Clemson were "local distribution" facilities.[70] Rather, the case turned on interpreting section 203 and whether it was intended to affect only acquisitions of jurisdictional facilities, or also to affect acquisitions of non-jurisdictional facilities. In interpreting section 203, however, the D.C. Circuit extensively analyzed and discussed the fundamental jurisdictional lines that Congress drew in section 201.

Citing to the CL&P case, the court in Duke stated:

The Act, as we have seen, effectuated federal control over the transmission and the sale at wholesale of electric energy in

[31,977]

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68 *Id.* at p. 210 n.6.

69 401 F.2d 930 (D.C. Cir. 1968) (Duke).

70 Duke delivered power to Clemson at a distribution voltage of 4,160 volts. The step-down transformers by which the voltage was reduced, and the substations at which the delivery was effected, were owned by Duke. 401 F.2d at p. 931, n.8.

interstate commerce, and established the Commission's regulatory power over public utilities engaging in either of these pursuits.[71]

However, quoting CL&P, the court further stated:

The expression "facilities used in local distribution" is one of relative generality. But as used in this Act it is not a meaningless generality in the light of our history and the structure of our government. We hold the phrase to be a limitation on jurisdiction and a legal standard that must be given effect in this case in addition to the technological transmission test.[72]

The court further rejected the Commission's concept that, in order to determine whether jurisdiction over any particular acquisition existed, the impact of local supervision be measured on a case-by-case basis. Quoting from Colton, the court stated:

[T]his "flexible approach"—involving as it does the consideration, inter alia, of "the effect of the regulation upon the national interest in the commerce"—has been flatly rejected as a technique for resolving jurisdictional conflicts between the Commission and state bodies. * * * We think that like the line "(i)t cut sharply and cleanly between sales for resale and direct sales for consumptive uses" to facilitate jurisdictional determinations in rate regulation, "Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction, making unnecessary such case-by-case analysis," in distributing regulatory power over the acquisition of facilities.[73]

The court rejected the Commission's argument that jurisdiction over the merger or consolidation of jurisdictional

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71 401 F.2d at pp. 938-39 (emphasis added, footnotes omitted).

72 *Id.* (footnote omitted).

73 *Id.* at p. 949 (footnotes omitted).

facilities with those of any other "person" under section 203 gave the Commission jurisdiction over Duke's acquisition. The court stated that the FPA reflects a policy ` that matters largely of a local nature, even though interstate in character, should be handled locally and should receive the consideration of local [officials] familiar with the local conditions in the communities involved.'"[74]

Federal Power Commission v. Florida Power & Light Company[75] is the last major court case to address the Commission's transmission jurisdiction. In this case, the Commission sought to impose its accounting rules upon Florida Power & Light Company (Florida Power & Light). The company's system lay solely within the borders of Florida and did not directly connect with any out-of-state utility.[76] The Commission held that Florida Power & Light did own facilities that transmitted electric energy in interstate commerce, but the Court of Appeals for the Fifth Circuit ruled that the Commission did not have substantial evidence to support its finding.

The Supreme Court reversed. The Supreme Court noted that Florida Power & Light was a member of the Florida Power Pool along with Florida Power Corporation (Florida Power Corp.).[77] In turn, Florida Power Corp. connected with Georgia Power Company (Georgia Power) at a "bus"[78] south

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74 *Id.* at p. 936 (quoting from Hearings on H.R. 5423 before the House Committee on Interstate and Foreign Commerce, 74th Cong., 1st Sess. 393 (1935) (testimony of then-FPC Commissioner Seavey)).

75 404 U.S. 453, *reh'g denied*, 405 U.S. 948 (1972) (*Florida Power & Light*).

76 404 U.S. at p. 456.

77 *Id.* at p. 456.

78 A "bus" is a connector or group of connectors that serves as a common connection for two or more circuits.

of the Georgia-Florida border.[79] Florida Power Corp. regularly exchanged power with Georgia Power.[80] In many instances, Florida Power Corp. transferred power to Florida Power & Light instantly after receiving power from Georgia Power, and transferred power to Georgia Power immediately after receiving power from Florida Power & Light.[81] The Supreme Court found that power commingled in the bus moved across state lines, and concluded that Florida Power & Light engaged in transmission in interstate commerce. The

[31,978]

Court held that, to establish jurisdiction, the Commission need only show that "some (Florida Power & Light) power goes out of State."[82] The Court further explained that "(i)f any (Florida Power & Light) power has reached Georgia, or (if Florida Power & Light) makes use of any Georgia power * * * FPC jurisdiction will attach * * *."[83]

There is also a line of cases that address, among other things, what constitutes a Commission jurisdictional "sale of electric energy at wholesale"[84] under section 201 of the FPA.[85] These cases all concerned bundled sales. While the issues posed above involve unbundled wheeling, the "resale" cases are helpful to the extent they suggest that local distribution takes place only after power is subdivided. See,

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79 404 U.S. at p. 457.

80 *Id.*

81 *Id.* at p. 457 & n.8.

82 *Id.* at p. 461. (emphasis omitted).

83 *Id.* at p. 461 n.10. (emphasis added).

84 See Section 201(d), 16 U.S.C. §824(d) (1988).

85 *Public Utilities Commission*, supra note 345; *City of Oakland, California v. FERC*, 754 F.2d 1378 (9th Cir. 1985) (*Oakland*). *See also Alexander v. FERC*, 609 F.2d 543 (D.C. Cir. 1979) (*Alexander*).

e.g., 345 U.S. at 316 ("the facilities supplied 'local distribution' only after the current was subdivided for individual consumers.").

4. Natural Gas Act

The Natural Gas Act (NGA) was adopted in 1938. Like the FPA, the NGA contains language limiting the Commission's jurisdiction in situations involving local distribution.[86]

Section 1(b) of the NGA provides:

The provisions of this Act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural.[87]

There is similarity in many respects between the House and Senate Reports on the FPA and the NGA with respect to the jurisdiction given the Commission. For example, all four reports mention Attleboro as placing interstate wholesale transactions beyond the reach of the States. As indicated in the House Report on the NGA, the States could "regulate sales to consumers even though such sales are in interstate commerce, such sales being considered local in character and in the absence of congressional prohibition subject to State regulation." (See H.R. Rep. No. 709, 75th Cong., 1st Sess. 1). However, the House and Senate Reports on the NGA

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86 Courts often rely on cases construing the NGA when interpreting the FPA, and vice versa. *E.g., Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981).

87 15 U.S.C. §717(b) (emphasis added).

contain identical language not found in the reports on the FPA:

In view of the importance of section 1(b), which states the scope of the act, it seems advisable to comment on certain provisions appearing therein. It will be noted that this subsection of the bill, after affirmatively stating the matters to which the act is to apply, contains a provision specifying what the act is not to apply to, as follows:

But shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

The quoted words are not actually necessary, as the matters specified therein could not be said fairly to be covered by the language affirmatively stating the jurisdiction of the Commission, but similar language was in previous bills, and, rather than invite the contention, however unfounded, that the elimination of the negative language would broaden the scope of the act, the committee has included it in this bill. That part of the negative declaration stating that the act shall not apply to "the local distribution of natural gas" is surplusage by reason of the fact that distribution is made only to consumers in connection with sales, and since no jurisdiction is given to the Commission to regulate sales to consumers the Commission would have no authority over

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distribution, whether or not local in character. (Emphasis added).[88]

As a result of this language it can be argued that Congress considered distribution (and local distribution) only

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[88] H.R. Rep. No. 709, 75th Cong., 1st Sess. 3 (1937); S. Rep. No. 1162, 75th Cong., 1st Sess. 3 (1937).

in the context of bundled retail sales of natural gas. In fact, it appears that all of the court cases affirming the states' right to regulate local distribution of gas have involved bundled retail sales. See Panhandle Eastern Pipe Line Co. v. Michigan Public Service Commission, 341 U.S. 329 (1951) (Panhandle). There the Court, in affirming the State of Michigan's right to regulate an interstate pipeline's proposed bundled retail sales of gas to industrial consumers, noted that the pipeline company proposed to lay pipeline in "the streets and alleys of Detroit" and ignored the local distribution company's request for additional gas to meet the increased needs of the industrial consumers. Id. at 333. While the Court based its holding on a state's authority to regulate direct (retail) sales to an end-user, rather than on the basis of the section 1(b) local distribution provision, it also found that the proposed sales were "primarily of local interest" and "emphasized the need for local regulation." Id. Two years before Panhandle, the Supreme Court issued its decision in FPC v. East Ohio Gas Co., 338 U.S. 465 (1949) (East Ohio). East Ohio Gas Company owned and operated a natural gas business wholly within the State of Ohio. The company sold gas only to Ohio customers but most of the gas was transported to Ohio from other states by interstate pipelines. These interstate pipelines connected inside Ohio with East Ohio's large high pressure lines. The gas then was transported over 100 miles through East Ohio's system to its local distribution system. East Ohio argued that it was exempt from Commission jurisdiction because all of its facilities were local distribution.

The Court disagreed, finding the Commission's jurisdiction extends over the transportation of gas in interstate commerce through high-pressure transmission lines and that distribution did not begin until the point where pressure is reduced and gas enters local mains. The Court stated that: "[w]hat Congress must have meant by 'facilities' for 'local distribution' was equipment for distributing gas among customers within a particular local community, not

the high-pressure pipelines transporting the gas to the local mains."[89]

The Commission relied in part on East Ohio's high pressure/low pressure distinction in a recent NGA section 7 certificate case which authorized construction of facilities to bypass the local distribution company.[90] On appeal, the California Commission argued that under section 1(b) it should at least have "jurisdiction over the 'taps, meters and other tie-in facilities' that link the pipeline to end users."[91] The court disagreed:

While as a matter of ordinary English 'local distribution' might be understood to encompass any delivery to an end user, that is hardly the only or even more plausible reading. Distribution conjures up receiving a large quantity of some good and parcelling it out among many takers.[92]

After reviewing the report language discussed above, the court also stated:

Insofar as congressional committees spoke to the matter * * * they appear to have viewed distribution as confined to its parcelling out function and (probably) even more narrowly, to parcelling out accompanied by retail sales.[93]

In Cascade Natural Gas Corporation v. FERC, et al. (Cascade), the court affirmed the Commission's authorizing

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89 338 U.S. at pp. 469-70.

90 *See Mojave Pipeline Company*, 35 FERC ¶61,199 (1986), *reh'g denied*, 41 FERC ¶61,040 (1987), *reh'g denied*, 42 FERC ¶61,351 (1988); *see also Mojave Pipeline Company*, 66 FERC ¶61,194 (1994), *reh'g pending*.

91 *See Public Utilities Commission of the State of California v. FERC, et al.*, 900 F.2d 269, 273 (D.C. Cir. 1990) (footnote omitted) (*WyCal*).

92 *Id.* at p. 276.

93 *Id.* (emphasis in original).

an interstate pipeline under section 7 of the NGA "to construct a tap and meter facility that would allow it to deliver natural gas directly to two industrial consumers

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* * *."[94] To reach the interstate pipeline, the industrials constructed a nine-mile pipeline. Together, the facilities bypassed the local distribution company.[95]

The court rejected arguments that section 1(b) deprived the Commission of jurisdiction holding that:

"Local distribution," as Congress viewed the term, involves two components: the retail sale of natural gas and its local delivery, normally through a network of branch lines designed to supply local consumers.[96]

5. Analysis

a. What facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to a purchaser who will then re-sell the energy to an end user?

The case law supports the conclusion that any facilities of a public utility used to deliver electric energy in interstate commerce to a wholesale purchaser, whether such facilities are labeled "transmission," "distribution" or "local distribution," are subject to the Commission's jurisdiction under sections 205 and 206.

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94 955 F.2d 1412, 1414 (10th Cir. 1992).

95 Unlike the situation in WyCal where the pipeline made direct sales to end users, in *Cascade*, the pipeline transported gas purchased from third parties. *See Northwest Pipeline Corporation*, 51 FERC ¶61,289 at p. 61,909 (1990).

96 Cascade, 955 F.2d at p. 1421.

This conclusion is supported by Public Utilities Commission, supra, in which the Supreme Court, in the section of its opinion addressing the section 201(b) local distribution provision, held that local distribution facilities began "only after the current was subdivided for individual consumers."[97] Wisconsin-Michigan, supra, in which the Seventh Circuit held that there is no local distribution until the wholesaler who re-sells at retail is reached, is to like effect.

This conclusion, which results in a "functional" line being drawn to determine Commission jurisdiction, is not only consistent with the case law under section 201, but is also consistent with our interpretation of the line drawn under newly amended FPA sections 211 and 212. As long as electric energy is being sold to a legitimate wholesale purchaser, we believe the Commission has jurisdiction under sections 201, 205, and 206 of the FPA over the public utility's facilities used to deliver electric energy to that purchaser.

b. What facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier directly to an end user?

In analyzing jurisdiction over unbundled retail wheeling, we believe it is important to distinguish between unbundled wheeling provided by the public utility who previously provided bundled retail service to the end user, and unbundled wheeling provided by other public utilities to the end user. For example, a former bundled retail customer may need unbundled wheeling services from its previous public utility generation supplier, as well as unbundled wheeling from one or more intervening public utilities, in order to reach a distant generation supplier. In this scenario, the

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[97] 345 U.S. at p. 316 (footnote omitted).

Commission believes it would have jurisdiction over all of the facilities used for the unbundled wheeling provided by the intervening public utilities.[98] The more difficult issue is whether some portion of the facilities used to transmit energy from the transmitting utility in closest proximity to the end user (the former supplier of the bundled product) is local distribution facilities. We believe that in most, if not all circumstances, some portion will be local distribution facilities.

The case law is replete with statements that the local distribution provision of section 201 must be given effect. However, the Supreme Court in both CL&P and Colton, supra, has stated that whether facilities are used in local distribution is a question of fact to be decided by the Commission as an original matter. Thus, there is no clear case law on a "bright line" between transmission and local distribution. In addition, regardless

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of the details of the chain of delivery services necessary to move electric energy from the generator to the end user, in most cases the last public utility in the chain will use facilities that historically were considered local distribution facilities. Accordingly, unlike the situation involving unbundled wholesale wheeling, for which the case law clearly supports a "functional" test, the Commission believes the case law and practical realities of a changing industry support an analysis of local distribution facilities based on the facilities' functional as well as technical characteristics.

While it would be preferable to draw an absolutely "bright" line (e.g., based on technical characteristics such as voltage), the Commission does not believe this is required by

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[98] The Commission would not have jurisdiction over the rates for the sale of generation by the distant supplier because the transaction would be a retail sale of electric energy.

the case law and, importantly, would not be a workable approach in all cases because of the variety of circumstances that may arise and because utilities themselves classify facilities differently (e.g., one utility may classify a 69 kV facility as transmission; another may classify it as distribution).

Therefore, the Commission is adopting several indicators it will evaluate in determining whether particular facilities are transmission or local distribution in the case of vertically integrated transmission and distribution utilities:[99]

- Local distribution facilities are normally in close proximity to retail customers.
- Local distribution facilities are primarily radial in character.
- Power flows into local distribution systems, it rarely, if ever, flows out.
- When power enters a local distribution system, it is not reconsigned or transported on to some other market.
- Power entering a local distribution system is consumed in a comparatively restricted geographical area.
- Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.
- Local distribution systems will be of reduced voltage.[100]

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[99] In the case of a distribution-only utility, which is franchised by a State or local government and sells only at retail, all of the circuits (and related wires, transformers, towers, and rights of way) which it owns or operates (regardless of voltage) would be local distribution facilities.

[100] The Commission has analyzed utilities' filings required by the Commission's regulations. These filings are made on FERC Form No. 1. While there is no uniform breakpoint between transmission and distribution, it appears that utilities account for facilities operated at

In summary, for unbundled wholesale wheeling the Commission will apply a functional test. The only definitive question will be whether the entity to whom the power is delivered is a lawful wholesaler. For unbundled retail wheeling the Commission will apply a combination functional-technical test that will take into account technical characteristics of the facilities used for the wheeling. The Commission concludes that these tests are consistent with the FPA, its legislative history and the case law discussed above.

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greater than 30 kV as transmission and that distribution facilities are usually less than 40 kV.

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Supreme Court, U.S.
FILED

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OFFICE OF THE CLERK

No. __-__

IN THE

Supreme Court of the United States

ENRON POWER MARKETING, INC.,

Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI (Volume II)

JEFFREY D. WATKISS
BRACEWELL & PATTERSON, L.L.P.
2000 K Street, N.W.
Suite 500
Washington, D.C. 20006
(202) 828-5800

LOUIS R. COHEN
Counsel of Record
JOSEPH E. KILLORY, JR.
IJAY PALANSKY
MICHAEL PLOTNICK
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, D.C. 20037-1420
(202) 663-6000

Counsel for Petitioner Enron Power Marketing, Inc.

323pm

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APPENDIX E

[30,172]

[¶31,048]

62 F.R. 12274 (March 14, 1997)

18 C.F.R. Part 35

[Docket Nos. RM95-8-001 and RM94-7-002; Order No. 888-A]

Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities

Issued March 4, 1997

AGENCY: Federal Energy Regulatory Commission.

ACTION: Final rules; order on rehearing.

SUMMARY: The Federal Energy Regulatory Commission (Commission) reaffirms its basic determinations in Order No. 888 and clarifies certain terms. Order No. 888 requires all public utilities that own, control or operate facilities used for transmitting electric energy in interstate commerce to have on file open-access non-discriminatory transmission tariffs that contain minimum terms and conditions of non-discriminatory service. Order No. 888 also permits public utilities and transmitting utilities to seek recovery of legitimate, prudent and verifiable stranded costs associated with providing open-access and Federal Power Act section 211 transmission services. The Commission's goal is to remove impediments to competition in the wholesale bulk power marketplace and to bring more efficient, lower cost power to the Nation's electricity consumers.

EFFECTIVE DATE: Changes to Order No. 888 made in this order on rehearing will become effective on [insert date 60 days after date of publication in the *Federal Register*].

FOR FURTHER INFORMATION CONTACT: David D. Withnell (Legal Information—Docket No. RM95-8-001), Office of the General Counsel, Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426, (202) 208-2063

Deborah B. Leahy (Legal Information—Docket No. RM94-7-002), Office of the General Counsel, Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426, (202) 208-2039

Dan T. Hedberg (Technical Information—Docket No. RM95-8-001), Office of Electric Power Regulation, Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426, (202) 208-0243

Joseph M. Power (Technical Information—Docket No. RM94-7-002), Office of Electric Power Regulation, Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426, (202) 208-1242

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14400, 12000, 9600, 7200, 4800, 2400, or 1200 bps, full duplex,

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I. Introduction and Summary

On April 24, 1996, the Commission issued Final Rules (Order Nos. 888 [FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996 ¶31,036] and 889 [FERC Statutes and Regulations, Regulations Preambles

January 1991-June 1996 ¶31,035) intended to remedy undue discrimination in the provision of interstate transmission services by public utilities and to address the stranded costs that may result from the transition to more competitive electricity markets.[1] At the heart of these rules is a requirement that prohibits owners and operators of monopoly transmission facilities from denying transmission access, or offering only inferior access, to other power suppliers in order to favor the monopolists' own generation and increase monopoly profits—at the expense of the nation's electricity consumers and the economy as a whole.

The electric utility industry today is not the industry of ten years ago, or even

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five years ago. While historically it was assumed that local utilities would be the only ones to generate and transmit power for their customers, today there is a broad array of potential competitors to supply power and widespread transmission facilities that can carry power vast distances. But competitors cannot reach customers if they cannot have fair access to the transmission wires necessary to reach those customers. It is against this industry backdrop that the Commission in Order No. 888 exercised its public interest responsibilities pursuant to sections 205 and 206 of the Federal Power Act (FPA), to reexamine undue discrimination in interstate transmission services and the effect of that

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[1] Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, 61 FR 21,540 (May 10, 1996), *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* ¶31,036, *clarified*, 76 FERC ¶61,009 and 76 FERC ¶61,347 (1996). Order No. 889 [*FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* ¶31,035] is an accompanying rule and specific rehearing arguments on that rule will be addressed separately.

discrimination on the electricity customers whom we are bound to protect under the FPA.

We here reaffirm the legal and policy bases on which Order No. 888 is grounded. Utility practices that were acceptable in past years, if permitted to continue, will smother the fledgling competition in electricity markets and undermine the national policies reflected in the Energy Policy Act of 1992 to encourage the development of competitive markets. We firmly believe that our authorities under the FPA not only permit us to adapt to changing economic realities in the electric industry, but also require us to do so, as necessary to eliminate undue discrimination and protect electricity customers. The record supports our conclusion that, absent open access, undue discrimination will continue to be a fact of life in today's and tomorrow's electric power markets. As recent events clearly demonstrate, unbundled electric transmission service will be the centerpiece of a freely traded commodity market in electricity in which wholesale customers can shop for competitively-priced power.

The only way to effectuate competitive markets and remedy discrimination is through readily available, non-discriminatory transmission access. The Commission estimates the potential quantitative benefits from such access will be approximately $3.8 to $5.4 billion per year in cost savings, in addition to the non-quantifiable benefits that include better use of existing assets and institutions, new market mechanisms, technical innovation, and less rate distortion.

Order No. 888 has two central components. The first requires all public utilities that own, operate or control interstate transmission facilities to offer network and point-to-point transmission services (and ancillary services) to all eligible buyers and sellers in wholesale bulk power markets, and to take transmission service for their own uses under the same rates, terms and conditions offered to others. In other

words, it requires non-discriminatory (comparable) treatment for all eligible users of the monopolists' transmission facilities. The non-discriminatory services required by Order No. 888, known as open-access services, are reflected in a *pro forma* open-access tariff contained in the Rule. The rule also requires functional separation of the utilities' transmission and power marketing functions (also referred to as functional unbundling) and the adoption of an electric transmission system information network.

The second central component of Order No. 888 was to address whether and how utilities will be able to recover costs that could become stranded when wholesale customers use the open-access tariffs, or FPA section 211 tariffs,[2] to leave their utilities' power supply systems and shop for power elsewhere. Because of competitive changes occurring at the retail level, as numerous states have begun retail transmission access programs, Order No. 888 also clarifies whether and when the Commission may address stranded costs caused by retail wheeling and the extent of the Commission's jurisdiction over unbundled retail transmission. The Commission further addresses the circumstances under which utilities and their wholesale customers may seek to modify contracts made under the old regulatory regime, taking into account the goals of reasonably accelerating customers' ability to benefit from competitively priced power and at the same time ensuring the financial stability of electric utilities during the transition to competition.

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[2] Under section 211 of the FPA, the Commission, on a case-by-case basis upon application by an eligible customer, may order both public utilities and non-public utilities that own or operate transmission facilities used for the sale of electric energy at wholesale to provide transmission services to the applicant if it finds it is in the public interest to issue such order.

137 entities filed requests for rehearing and/or clarification of Order No. 888. While these parties raise a variety of arguments—including legal, policy, and technical arguments—the majority (including a majority of public utilities) agree that we need to harness the benefits that competitive electricity markets can bring to the nation. The disagreements primarily focus on the mechanics of how we should do this, who should pay the costs of the transition to competition, and how long the transition should take.

First, parties disagree on what is necessary to remedy undue discrimination and to develop truly competitive wholesale markets. Many focus specifically on the tariff terms and conditions of good transmission access and seek changes in the Order No. 888 *pro forma* tariff. In response to these types of rehearing arguments, the Commission has fine-tuned or changed some of the *pro forma* tariff terms and conditions to better ensure that they do not permit discrimination and that they result in well-functioning markets. Other petitioners focus on additional structural changes which they believe are necessary, such as mandatory corporate restructuring (divestiture of generation assets) or mandatory creation of independent transmission system operators (ISOs). With regard to restructuring, the Commission continues to believe that functional unbundling of the utility's business, not corporate divestiture or mandatory ISOs, is sufficient to remedy undue discrimination at this time.

The most contentious arguments raised on rehearing involve how we deal with the transition costs associated with moving to competition. Some utilities have invested millions of dollars in facilities and purchased power contracts based on an explicit or implicit obligation to serve customers and the expectation that those customers would remain on their systems for the foreseeable future. These utilities face so-called "stranded costs" which, if not recovered from the

customers that caused the costs to be incurred, could be shifted to other customers.

There are two basic categories of rehearing arguments regarding stranded cost recovery. Most utilities want a guarantee from this Commission that they will recover all stranded costs, whether caused by losing retail customers or wholesale customers. Many customers, on the other hand, want to be able to abrogate existing power supply contracts so that they can immediately leave their current suppliers' systems and shop for cheaper power elsewhere, without paying the sunk costs that their suppliers incurred on their behalf.

In response to these diverse arguments, the Commission has struck a reasonable balance that, for certain defined circumstances, permits utilities the *opportunity* to seek extra-contractual recovery of stranded costs from their departing customers and permits customers the *opportunity* to make a showing that their contracts should be shortened or terminated. Based on our experience in the natural gas area, we have learned that it is critical to address these issues early, but we also have chosen an approach different from that taken in the gas area because of the different circumstances facing the electric industry.

In balancing the wide array of interests reflected in the rehearing petitions, we have made a number of clarifications and granted rehearing on some issues, but we reaffirm the core elements and framework of Order No. 888. Since the time the final rules issued, as discussed in section III, the pace of competitive change has continued to escalate in the industry at both the wholesale and retail levels as competitors, customers and state regulatory authorities aggressively seek ways to lower the price of electricity. We therefore believe it is all the more critical that we remedy undue discrimination in interstate transmission services now, and that we do so generically, if we are to fulfill our responsibilities under the FPA to protect consumers and

provide a fair and orderly transition to new competitive markets.

Finally, with respect to environmental issues associated with this rulemaking, certain parties on rehearing continue to challenge the adequacy of our Final Environmental Impact Statement (FEIS). The central issues are whether the Final Rule will increase emissions of nitrogen oxides (NO_x) from certain fossil-fuel fired generators, which could affect air quality in downwind areas to which these emissions may be carried, and the Commission's authority to mitigate environmental consequences.

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We deny rehearing on the environmental issues raised and affirm our conclusion that we have satisfied our obligations under NEPA. As discussed in detail in the Final Rule, this rulemaking is expected to slightly increase or slightly decrease total future NO_x emissions, depending on whether competitive conditions in the electric industry favor the utilization of natural gas or coal as a fuel for the generation of electricity. We also examined mitigation options over the longer term, and found that the preferred approach for mitigating any adverse environmental consequences would be for the Environmental Protection Agency (EPA) and the states to address the problem through regulatory authorities available under the Clean Air Act. The petitions for rehearing have not persuaded us to change this approach. Indeed, we note that since the issuance of Order No. 888, the EPA has concluded that the rule is unlikely to have any immediate significant adverse environmental impact and thus concurred that the Commission's analysis is adequate under NEPA. We further note that EPA has recently taken steps under the Clean Air Act to address NO/x/ emissions as part of a comprehensive emissions control program, along the lines endorsed by the Commission in the EIS.

In summary, the Commission believes that our authorities under the FPA not only permit us to adapt to changing economic realities in the electric industry, but also require us to do so to eliminate undue discrimination and protect electricity customers. The measures required in Order No. 888 are necessary to remedy undue discrimination in interstate transmission services and provide an orderly and fair transition to competitive bulk power markets.

To assist the reader, we provide below a section-by-section summary of key elements of this Order on Rehearing.

Scope of the Rule

In this section we discuss petitions to rehear our requirement that transmission and power sales services be contracted for separately (unbundled). We reaffirm that this requirement is a reasonable and workable means of assuring non-discriminatory open-access transmission. In doing so we refuse invitations to require that utilities under our jurisdiction divest themselves of generation or transmission assets. We do, however, make an important clarification involving how we will deal with existing contracts that contain so-called *Mobile-Sierra* clauses (clauses under which one or both parties agreed not to seek modification of contract terms unless they could show that it is contrary to the public interest not to permit the modification).

In Order No. 888 we concluded that contracts would not be abrogated by operation of the Rule. Instead, preexisting contracts would continue to be honored until such time as they were revised or terminated. We also found that those who were operating under pre-existing requirements contracts containing *Mobile-Sierra* clauses would nonetheless be allowed to seek reform of the contracts on a case-by-case basis. On rehearing we affirm that public utilities will be allowed to file to amend their *Mobile-Sierra* contracts for the limited purpose of providing an opportunity to seek recovery of stranded costs, without having to make a

public interest showing that such cost recovery should be permitted. However, these utilities will have the burden, on a case-by-case basis, of showing that they had a reasonable expectation of continuing to serve the departing customer after the contract term. We clarify that if the utilities under such contracts seek to modify provisions that do *not* relate to stranded costs, they will have the burden of showing that the provisions are contrary to the public interest.

We here make clear that, in turn, customers will be allowed to file to amend their *Mobile-Sierra* contracts to modify any contract term or to terminate the contract, without having to make a showing that the contract terms are contrary to the public interest. Instead, customers seeking modifications must demonstrate that the provisions they wish modified are no longer "just and reasonable." We reaffirm our conclusion in the Final Rule that if a customer seeks to shorten or eliminate the term of its contract, however, any contract modification approved by the Commission will provide for appropriate stranded cost recovery by the customer's supplying utility.

These various provisions meet the two-fold need to deal with stranded costs and the contracts under which those costs were incurred. However, as described in

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Order No. 888, the opportunity to reform *Mobile-Sierra* contracts extends only to a limited set of contracts—those entered into on or before July 11, 1994, for requirements power.

Comparability

In this section we deal with those requesting rehearing of our conclusions regarding what "comparable" service is, who is eligible for that service, and how it is to be implemented. We reaffirm our finding that, as a matter of law, we have jurisdiction over the rates, terms and conditions of unbundled

transmission service provided to retail customers. We also clarify that we have authority to order "indirect" unbundled retail transmission services and that if such transmission is ordered by us in the future, or if it is provided voluntarily, otherwise eligible customers may obtain such service under the open-access tariff. We expect public utilities to provide such service in the future and, if they do not, we will not hesitate to order it.

We modify in two respects the definition of who is eligible for open-access transmission service. First, we clarify that, with respect to service that this Commission is prohibited from ordering by section 212(h) of the Federal Power Act (retail wheeling directly to an ultimate consumer and "sham" wholesale wheeling), entities are eligible for such service under the tariff only if it is provided pursuant to a state requirement or is provided voluntarily. Second, we clarify that retail customers taking unbundled service pursuant to a state requirement (i.e., direct retail service) are eligible for such service only from those transmission providers that the state orders to provide service. These changes are made to make clear that our rules cannot be used to circumvent the proscriptions placed on the Commission against ordering direct retail wheeling.

Ancillary Services

In this section we deal with petitions to rehear our definitions of ancillary services—those services such as scheduling, voltage control, and supplemental reserve service that must or can attend the providing of transmission service—as well as the provisions involving these services. We reaffirm that tariffs must separately state the charges for these services. We do modify some of the definitions of these services to conform to industry needs and practices. Most importantly, we make clear that the transmission provider's sale of ancillary services associated with providing basic transmission service is not a wholesale merchant function

and thus does not violate the standards of conduct imposed with Order No. 889.

Coordination Arrangements

The requirement to provide non-discriminatory open-access transmission applies to any agreement between utilities that contains transmission rates, terms or conditions. This includes pooling arrangements and agreements between companies contracting to provide each other mutually beneficial transmission services. In Order No. 888 we laid out rules under which the open-access comparability requirements would apply to tight and loose power pools, public utility holding companies and bilateral coordination agreements. We also set out principles that would govern our approval of independent system operator (ISO) agreements.

In this section we affirm the rules governing coordination agreements. In doing so we clarify the definition of "loose pool." We also make clear that, unlike in other situations where we require utilities to provide not only the services they provide themselves but those they could provide themselves, we will require members of loose pools to offer to third parties only those transmission services that they provide themselves under their pool-wide agreements.

We also reaffirm our strong commitment to the concept of ISOs and the ISO principles described in Order No. 888. In doing so we reject arguments that we should require that ISOs be formed. At the same time, we emphasize that while there is no "cookie-cutter" approach to forming an acceptable ISO, the requirement of fair and non-discriminatory rules of governance (Principle One) and the requirement that ISO employees have no financial interest in the economic interests of power marketers—backed by strict conflict of interest provisions—(Principle Two) are fundamental to our approving any ISO.

Pro Forma Tariff Provisions

The *pro forma* tariff is the basic mechanism implementing the requirements of comparable open-access transmission. It

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provides the details of the transmission service obligations imposed on jurisdictional utilities by the Rule. On rehearing we affirm most of the provisions set out in Order No. 888 for the *pro forma* tariff. We do make changes to conform the *pro forma* tariff to changes adopted under other sections (for example, the definition of "eligible customer").

The rehearing petitions raised many questions about how particular aspects of the tariff will work. For the most part, these questions cannot be answered generically, but must be resolved on a case-by-case basis in the context of specific fact situations. However, the petitions brought to light issues that require clarifications and in some cases revisions to the tariff. The most significant of these involve discounting practices, provisions governing priority of service and curtailment, and the reciprocity provision.

Discounting practices. Originally, we provided different rules depending upon whether the transmission provider was offering a discount to itself or an affiliate or offering a discount to a non-affiliate. In response to the rehearing petitions, we are making three significant changes to the discounting requirements to better permit the ready identification of discriminatory discounting practices while also providing greater discount flexibility.

First, any discount offered on transmission services (including supporting ancillary services) by a transmission provider or requested by any customer must now be made only over the OASIS. With this change, all will have the same, timely access to discounted services. In making this change, we clarify that a transmission provider may limit its discounted service to particular time periods.

Second, once the provider and customer agree on a discount, the details of the discounted service—the price, points of receipt and delivery, and length of service—must be immediately posted on the OASIS.

Third, we revise our rule respecting what other transmission paths must be offered at a discount. Originally, in Order No. 888, we required that when a discount was offered over one path, the transmission provider would have to provide that discount over all other unconstrained paths on its system. We will no longer require this. Instead, the discount will be limited to those unconstrained paths that go to the same point(s) of delivery as the discounted service being provided on the transmission provider's system. The discount will extend for the same time period and must be offered to all transmission service customers.

Priority and Curtailment. We affirm the right of first refusal policy that reservation priority continues for firm service customers served under a contract of one year or more. We also affirm that curtailment must be made on a pro-rata basis and clarify that non-firm point-to-point service is subordinate to firm service. However, we clarify that the pro-rata curtailment requirement extends to only those transactions that alleviate the constraint.

Reciprocity. In Order No. 888 we conditioned the use of a public utility's open-access service on the agreement that, in return, it is offered reciprocal service by non-public utilities that own or control transmission facilities. Such reciprocal service does not have to be through an open-access tariff, i.e., a tariff available to all eligible customers, but may be limited to those public utilities from whom the non-public utility obtains open-access service. We affirm the reciprocity condition. In doing so, however, we make several clarifications.

First, a public utility is free to offer transmission service to a non-public utility without requiring reciprocal service in

return. In other words, it may voluntarily waive the reciprocity condition. However, if it chooses to do so, transmission service must be provided through the *pro forma* tariff. Alternatively, bilateral agreements for transmission service provided by the public utility will not be permitted.

Second, we clarify that under the reciprocity condition a non-public utility must agree to offer the Transmission Provider any transmission service the non-public utility provides or is capable of providing on its system. This means that the non-public utility undertaking reciprocity must have an OASIS and must operate under the standards of conduct imposed under Order No. 889 unless it is granted a waiver by the Commission or, where appropriate, by a regional transmission group (RTG) of which it is a member. We also clarify that a non-public utility cannot avoid its responsibilities by

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obtaining transmission service through other transmission customers. Further, the seller as well as the buyer in the chain of a transaction involving a non-public utility will have to comply with the reciprocity condition.

Third, we adhere to our decision not to treat generation and transmission (G&T) cooperatives and their member distribution cooperatives as a single unit. Thus, the reciprocity provision extends to the G&T Cooperative and not to its member distribution cooperatives.

Fourth, we clarify the "safe harbor" provision under which a non-public utility may get a Commission decision that its transmission tariff suffices to meet reciprocity. A non-public utility may limit the use of any reciprocity tariff that it voluntarily files at the Commission to those transmission providers from whom the non-public utility obtains open-access service. A non-public utility also may satisfy reciprocity through bilateral agreements with a public utility. As a related matter, if a public utility believes a non-public

utility is violating the reciprocity condition, it may file with the Commission a petition to terminate its service to the non-public utility.

Fifth, we clarify that non-public utilities may include stranded cost provisions in their reciprocity tariffs.

Sixth, the order on rehearing removes the term "interstate" from the reciprocity provisions. This is to make clear that reciprocity applies even to those who do not own or control interstate transmission facilities; *i.e.*, foreign utilities and those located in the ERCOT region of Texas.

As to local furnishing bonds held by some public utilities, we clarify that all costs associated with the loss of tax-exempt status of those bonds caused by providing open-access transmission service are properly considered costs of providing that service. This includes costs of defeasing, redeeming, and refinancing those bonds.

Other Clarifications. In this order on rehearing we take the opportunity to clarify various other tariff provisions. Among these: Transmission providers do not have to take service under the open-access tariff for transmitting power purchased on behalf of their bundled retail customers. Also, the ability to reserve capacity to meet the reliability needs of a transmission provider's native load applies equally to present transmission and transmission that is built in the future.

Implementation

On rehearing, we make no substantive changes to the implementation provisions originally required under Order No. 888. For the most part, the implementation process has been completed. Utilities have made the requisite tariff and compliance filings and public and non-public utilities have, through other orders, been provided guidance as to obtaining waivers of Order No. 888 and Order No. 889 requirements.

We emphasize that we do not require the abrogation of existing contracts. Rather, the Rule requires only that transmission providers offer transmission under the open-access tariff in addition to existing service obligations. Commitments made under existing contracts will continue. Of course, both transmission providers and their customers may seek to revise the terms and conditions of existing contracts by making the necessary filings, as appropriate, under sections 205 or 206 of the Federal Power Act.

State and Federal Jurisdiction

On rehearing we reaffirm our decision that when transmission service is provided to serve retail customers apart from any contract for the retail sale of power, i.e., when it is provided on an unbundled basis, that transmission service is under our jurisdiction. In today's market, and increasingly in the future as more states adopt retail wheeling programs, retail transactions are, and will be, broken down into products that are sold separately—transmission and generation—and sold by different entities. The exercise of our jurisdiction over the rates, terms and conditions of unbundled retail transmission will, therefore, become more important. We also recognize that states have jurisdiction over facilities used for local distribution.

On rehearing we also reaffirm the seven-factor test of Order No. 888 to distinguish transmission under our jurisdiction from state-jurisdictional local distribution. In doing so, we recognize that our test does not resolve all possible issues. There may be other factors that should be taken into account. The test, therefore, is designed for flexibility to include

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unique local characteristics and usages. To that end, we will continue to defer to state findings on these matters.

In addition, we clarify that states have the authority to determine the retail marketing areas of the electric utilities within their respective jurisdictions. We also recognize that states have the concomitant authority to determine the end-user services these utilities provide.

Stranded Costs

On rehearing, we reaffirm our basic decisions surrounding the recovery of stranded costs. Utilities will be allowed the opportunity to seek to recover legitimate, prudent, and verifiable wholesale stranded costs. This opportunity is limited to costs associated with serving customers under wholesale requirements contracts executed on or before July 11, 1994 that do not contain explicit stranded cost provisions; and costs associated with serving retail-turned-wholesale customers.

We clarify that we will consider on a case-by-case basis whether to treat a contract extended or renegotiated without a stranded cost provision as an existing contract for stranded cost purposes.

In each case, the opportunity to seek stranded costs is limited to situations in which there is a direct nexus between the availability and use of a Commission-required transmission tariff and the stranding of the costs. The Rule does not allow the recovery of costs that do not arise from the new, accelerated availability of non-discriminatory transmission access.

The Commission also reaffirms its decision that stranded costs should be recovered from the customer that caused the costs to be incurred. The Commission is not requiring other remaining customers, or the utility, to shoulder a portion of its stranded costs that meet the requirements for recovery.

The Commission, as described in Order No. 888, will be the primary forum for addressing the recovery of stranded

costs caused by retail-turned-wholesale customers. With respect to such cases, we have made several changes.

First, the Commission has reconsidered its decision respecting cases involving existing municipal utilities that annex retail customer service territories. Under Order No. 888, we found that in such cases the Commission should not be the primary forum for determining stranded cost recovery. On rehearing we now find that such cases should fall within our province.

Second, we clarify that the opportunity for recovery of stranded costs associated with retail-turned-wholesale customers applies regardless of whether the customer or its new supplier is the one requesting and contracting for the transmission service. To this end, we have revised the definition of "wholesale stranded cost."

With respect to the recovery of stranded costs caused by unbundled retail wheeling, we affirm that the only circumstance in which we will entertain requests for these types of costs is when the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required. We clarify that if a state regulatory authority has in fact addressed such costs, regardless of whether it has allowed full recovery, partial recovery or no recovery, utilities may not apply to the Commission to recover stranded costs caused by the retail wheeling.

Other

In this section we resolve questions concerning our information reporting requirements, regional transmission groups, and the special situations posed by utilities in the Pacific Northwest and by federal power marketing and similar agencies. Here we make some minor clarifications but make no significant changes to Order No. 888.

We are not persuaded that the information reporting requirements need to be changed at this time. Finally, we reject arguments that would have us fix generically any particular rate methodology for providing open-access transmission service under the *pro forma* tariff.

II. Public Reporting Burden

This order on rehearing issues a number of minor revisions to the Final Rule. We find, after reviewing these revisions, that they do not, on balance, increase the public reporting burden.

The Final Rule contained an estimated annual public reporting burden based on the requirements of the Open Access Final Rule and the Stranded Cost Final

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Rule.[3] Using the burden estimate contained in the Final Rule as a starting point, we evaluated the public burden estimate contained in the Final Rule in light of the revisions contained in this order and assessed whether this estimate needed revision. We have concluded, given the minor nature of the revisions, and their offsetting nature, that our estimate of the public reporting burden of this order on rehearing remains unchanged from our estimate of the public reporting burden contained in the Final Rule. The Commission has conducted an internal review of this conclusion and has assured itself that there is specific, objective support for this information burden estimate. Moreover, the Commission has reviewed the collection of information required by the Final Rule, as revised by this order on rehearing, and has determined that the collection of information is necessary and conforms to

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[3] 61 FR 21540 at p. 21543; *FERC Statutes and Regulations, Regulations, Preambles January 1991 - June* ¶31,036, at p. 31,638 (1996). No comments were filed in objection to the public burden estimate contained in the Open Access Final Rule and the Stranded Cost Final Rule.

the Commission's plan, as described in the Final Rule, for the collection, efficient management, and use of the required information.

Persons wishing to comment on the collections of information required by the Final Rule, as modified by this order on rehearing, should direct their comments to the Desk Officer for FERC, Office of Management and Budget, Room 3019 NEOB, Washington, DC 20503, phone 202-395-3087, facsimile: 202-395-7285 or via the Internet at hillier_t@a1.eop.gov. Comments must be filed with the Office of Management and Budget within 30 days of publication of this document in the *Federal Register*. Three copies of any comments filed with the Office of Management and Budget also should be sent to the following address: Ms. Lois Cashell, Secretary, Federal Energy Regulatory Commission, Room 1A, 888 First Street, NE., Washington, DC 20426. For further information, contact Michael Miller, 202-208-1415.

III. Background

In the Final Rule, we detailed the events that led up to this rulemaking, including the significant technical, statutory and regulatory changes that have occurred in the electric industry since the FPA was enacted in 1935.[4] In particular, we focused on the competitive influences of the Public Utility Regulatory Policies Act of 1978, the Congressional mandate in the Energy Policy Act of 1992 to encourage competition in electricity markets, and the need for reform in the industry if consumers are to achieve the benefits that greater competition can bring.

In the ten months since the Final Rule issued, competitive changes have escalated at an even faster pace in virtually all areas of the electric industry. These changes are

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[4] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,638-52; *mimeo* at pp. 13-51.

driven not only by the Commission's Final Rule, but also by state restructuring initiatives and by continuing pressures from customers to take advantage of emerging competitive markets and the lower electricity rates they can bring.

All of the existing 166 public utilities that own, control or operate interstate transmission facilities (listed as Group 1 and Group 2 utilities in the Final Rule) have filed the Order No. 888 *pro forma* open-access tariff or requested a waiver of the requirement. Similarly, they either have adopted an electronic information network or requested a waiver of the requirement. Five non-public utilities have submitted reciprocal transmission tariffs and more than 20 have requested a waiver of the reciprocity condition in the *pro forma* tariff.[5]

Significant competitive changes also have accelerated with respect to power pooling, state restructuring initiatives, and Independent System Operators (ISOs). Under Order No. 888 and subsequent implementation orders, the Commission

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required the filing of revised pooling agreements and joint pool-wide transmission tariffs by December 31, 1996, in order to remedy undue discrimination in transmission services provided through interstate power pooling arrangements. Among the power pool filings were a New England (NEPOOL) comprehensive restructuring proposal, a New York proposal, a Pennsylvania-New Jersey-Maryland (PJM) compliance filing and a Western Systems Power Pool filing.

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[5] As a condition of using a public utility's open-access tariff, any user, including non-public utilities, must offer reciprocal comparable transmission access to the public utility in return. Order No. 888 provides a voluntary mechanism whereby non-public utilities can obtain Commission confirmation that what they are offering meets the tariff reciprocity condition. Non-public utilities also may seek a waiver of the reciprocity condition.

In response to the Commission's encouragement in Order No. 888 of ISOs as a possible means for accomplishing comparable access, a number of utilities and states are well underway in developing this new institution. The fundamental purpose of an ISO is to operate the transmission systems of public utilities in a manner that is independent of any business interest in sales or purchases of electric power by those utilities. The Commission has received several proposals for forming ISOs, one as part of the multi-docketed filing engendered by California's restructuring plan, and others relating to power pool filings. A number of regions are also developing ISO proposals. Some regions previously considering regional transmission groups (RTGs), whose primary purpose is regional planning of transmission facility construction and upgrades, have now broadened their discussions to include an ISO.

Investor-owned utilities in California, at the order of both the state commission and the legislature, have filed proposals with the Commission that would transfer control of transmission facilities to an ISO in conjunction with the formation of a state-wide power exchange to facilitate both wholesale and retail access. While the case presents many complex issues for the Commission to resolve, the California proposal is fundamentally compatible with the pro-competitive open-access requirements of Order Nos. 888 and 889. The Commission's open-access policies therefore have provided a framework for California, and other states, to explore customer choice initiatives.

Other major regions of the country also are instituting ISOs. Member utilities of the PJM Power Pool filed competing ISO proposals with the Commission and are currently working to reconcile the differences between their proposals. The New York Power Pool recently filed a proposal to create an ISO and a power exchange for New York. The New England Power Pool is exploring a new industry structure for its region that centers on the creation of

an ISO. Utilities and other market participants in the Electric Reliability Council of Texas have also formed an ISO. Discussions are underway among utilities from Virginia to Wisconsin in an attempt to create a Midwestern ISO. Members of the Mid-America Power Pool are discussing an ISO proposal. In the Pacific Northwest, utilities are involved in negotiations intended to lead to the formation of an independent grid operator (Indego).

The combined available generation resources of the utilities in these groups is on the order of 428 GW out of a total of approximately 732 GW for total U.S. resources (as of the end of 1996). Thus, assuming these ISO arrangements come to fruition, about three-fifths of the industry may have independent system operators controlling their transmission systems.

Moreover, every state but one has proposed or is considering or developing retail competition programs. For example, New Hampshire, Illinois and Massachusetts began pilot programs in the past year, and retail transmission service for these pilot programs currently is being taken pursuant to tariffs approved by both the state commissions and this Commission. The Massachusetts Department of Public Utilities has sent a proposal to the state legislature calling for retail competition to begin in January 1998. The New York Public Service Commission has issued an order proposing that retail competition begin in early 1998. The New Jersey Board of Public Utilities has issued a proposal permitting customer choice beginning in October of 1998. The Vermont Public Service Board has sent a plan to the legislature recommending that full customer choice begin by the end of 1998. The Arizona Corporation Commission has adopted rules to phase-in competition over four years, beginning in January 1999. Recently, the Maine Public Utilities Commission issued a final report and recommendation to the legislature for retail competition to begin in January 2000. In addition, Rhode Island and

Pennsylvania both have new laws requiring customer choice. These are only a few of the many state initiatives that are under-

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way that will dramatically alter the structure of the electric industry.

Since Order No. 888 was issued, significant efforts also have been made to ensure that reliability of the transmission grid is maintained and that reliability criteria are compatible with competitive markets. The North American Electric Reliability Council (NERC) has continued its efforts to broaden its membership and to fashion reliability requirements to fit a more competitive electric power industry. For example, the NERC Board of Directors voted to require mandatory compliance by all power market participants with its reliability standards. NERC is also establishing new entities called regional security coordinators to oversee the stability of grid operations and to direct the development of an extensive new communications network. Various NERC committees are considering ways to improve the tracking of power transactions, identify the network impacts of transactions, and reflect the actual flow of power over the network when making reservations for transmission service. These efforts are likely to intensify as the industry continues to adapt to competitive changes occurring in the marketplace.

Thus, all segments of the electric industry have taken significant steps in the past year in response to the emerging wholesale competitive markets enabled by Order No. 888 as well as state retail competition initiatives. The competitive framework established by Order No. 888, whose centerpiece is non-discriminatory transmission services and a fair and orderly stranded cost recovery mechanism, is critical to the successful transition to, and full development of, the industry

restructuring proposals that are well underway in all major regions of the country.

IV . Discussion

A.Scope of the Rule

1. Introduction

Rehearing Requests

Severability of Rules

Several entities assert that the Commission should find that the requirements of open-access transmission and stranded cost recovery are not severable.[6] They argue that if one of these provisions is invalidated by a court or otherwise removed, the orders in their entirety should be withdrawn or stayed pending reconsideration by the Commission, and public utilities should be allowed to withdraw or file amended transmission tariffs.

Commission Conclusion

The Commission will not, at this time, make any determination whether or not the open-access transmission, stranded cost recovery and OASIS provisions of Order Nos. 888 and 889 are severable. Accordingly, we make no finding whether, if one of these provisions is invalidated, Order Nos. 888 and 889 should be withdrawn or stayed in their entirety. We believe that our decisions in Order Nos. 888 and 889 will be upheld by the courts. Moreover, it would be premature to consider the appropriateness of a stay or withdrawal at this time. Circumstances at the time of any court order would dictate how we should proceed and we would consider all such circumstances, and the entirety of our policy decisions, before determining how to respond to a court decision.

2. Functional Unbundling

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[6] *E.g.*, Nuclear Energy Institute, Southern, EEI. EEI and Nuclear Energy Institute also argue that Order No. 889 should not be severable.

In the Final Rule, the Commission found that functional unbundling of wholesale generation and transmission services is necessary to implement non-discriminatory open-access transmission.[7] At the same time, the Commission recognized that additional safeguards were necessary to protect against market power abuses. Thus, the Commission adopted a code of conduct, discussed in detail in the Final Rule on OASIS, to ensure that the transmission owner's wholesale power marketing personnel and the transmission customer's power marketing personnel have comparable access to information about the transmission system. The Commission also noted that section 206 of the FPA is available if a public utility seeks to circumvent the functional unbundling requirements.

As a further precaution against unduly discriminatory behavior, the Commission

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stated that it will continue to monitor electricity markets to ensure that functional unbundling adequately protects transmission customers. The Commission also indicated that it would continue to observe both the evolution of competitive power markets and the progress of the industry in adapting structurally to competitive markets. If it subsequently becomes apparent that functional unbundling is inadequate or unworkable in assuring non-discriminatory open-access transmission, the Commission indicated that it would reevaluate its position and decide whether other mechanisms, such as ISOs, should be required.

The Commission concluded that functional unbundling, coupled with these safeguards, is a reasonable and workable means of assuring that non-discriminatory open-access transmission occurs. In the absence of evidence that

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[7] FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996 at pp. 31,654-56; mineo at pp. 57-61.

functional unbundling will not work, the Commission indicated that it was not prepared to adopt a more intrusive and potentially more costly mechanism—corporate unbundling—at this time.

Rehearing Requests

Several entities disagree with the Commission's decision to require functional unbundling of wholesale generation and transmission as a means of assuring non-discriminatory open-access transmission.[8] American Forest & Paper argues that utilities must be required to divest or spin-off their generating assets through operational unbundling or divestiture. It alleges that it was arbitrary and capricious, and not supported by evidence, for the Commission to rely on a monopolist's code of conduct to protect against monopoly abuses. Nucor asserts that a financial conflict of interest remains and that the Commission cannot monitor the exchanges of information between utility generation and transmission employees. It declares that a credible information disclosure requirement is needed that makes generation cost and production data visible to all participants on a same-time basis. NY Municipal Utilities also believes that the Commission did not go far enough and argues that the Commission should have required operational unbundling, at least for tight power pools.

Commission Conclusion

The Commission reaffirms its finding in the Final Rule that, based on the information available at this time, functional unbundling, along with the flexible safeguards discussed in the Final Rule, is a reasonable and workable means of assuring non-discriminatory open-access transmission. We see no need to adopt a more intrusive and potentially more costly approach at this time based on speculative allegations that functional unbundling may not

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[8] *E.g.*, American Forest & Paper, Nucor, NY Municipal Utilities.

work and that more severe measures may be needed. Indeed, despite a number of opportunities to do so, no entity has submitted any evidence suggesting that this less intrusive approach would not work. We do emphasize, however, that we have not adopted a rigid approach, but have indicated a willingness to monitor the situation and, if events require, reevaluate our decision and decide whether another mechanism may be more appropriate. Until we see evidence that functional unbundling will not work, we will continue to require functional unbundling, with the safeguards enumerated in the Final Rule and in Order No. 889.

3. Market-Based Rates

a. Market-Based Rates for New Generation

In the Final Rule, the Commission codified its determination in Kansas City Power & Light Company (KCP&L)[9] that the generation dominance standard for market-based sales from new capacity should be dropped.[10] The Commission explained that it had yet to find an instance of generation dominance in long-run bulk power markets and no commenter had presented any evidence to that effect. However, the Commission emphasized that it will not ignore specific evidence presented by an intervenor that a seller requesting market-based rates for sales from new generation nevertheless possesses generation dominance.

The Commission further clarified that dropping the generation dominance standard for new capacity does not affect the

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demonstration that an applicant must make in order to qualify for market-based rates for sales from its existing generating capacity.

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9 67 FERC ¶61,183, at p. 61,557 (1994).

10 *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,656-57; *mimeo* at pp. 63-66.

Rehearing Requests

Several entities take issue with the Commission's determination to drop the generation dominance standard for market-based sales from new capacity.[11] American Forest & Paper argues that the Commission should delay its decision until effective competition has been demonstrated to exist in all markets. SC Public Service Authority maintains that the Commission must determine on a case-by-case basis whether public utilities have market power (for both existing and new capacity). It further argues that the Commission must develop an analysis of structural conditions to use in assessing the potential for market power consistent with that used by DOJ and FTC in merger proceedings and that reflects the conditions of the industry. SC Public Service Authority also asserts that the Commission must require as a condition of market rates for sales in the bulk power market, which it defines to be limited to sales to integrated utilities, that the selling utility file rate cases with the Commission and the applicable state commissions to avoid subsidization by captive consumers.

TDU Systems alleges that the long-run bulk power market upon which the KCP&L decision was based is overly broad and ignores the distinction between firm power, which "entities subject to others' market power are most commonly in need of" and other bulk power services. TDU Systems take issue with the Commission's conclusion in KCP&L that large numbers of capacity offers from IPPs and QFs demonstrate that the market abounds with competitors. TDU Systems argues that the Commission's "assumption that large numbers of offers of power equate with large numbers of offers of firm power is questionable at best, and very likely incorrect."[12] Similarly, LEPA argues that the Commission

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[11] *E.g.*, American Forest & Paper, SC Public Service Authority, TDU Systems, LEPA, San Francisco.

[12] TDU Systems at p. 92.

ignored evidence submitted by LEPA in comments "that the transmission dominant utility still retained monopoly power over RQ [requirements] markets on which LEPA's members are dependent for their bulk power supply." Because the Commission ignored the RQ market and the evidence of concentration in that market, LEPA asserts that the Commission's decision is reversible error. LEPA further argues that the Commission ignored the undisputed testimony of LEPA's witness that reliability requirements constrain the geographic scope of the RQ market severely.

San Francisco argues that the burden to demonstrate affirmatively the absence of capacity constraints as a precondition to receiving authority to charge market-based rates for sales from new capacity should be upon public utility applicants, who possess the information concerning capacity constraints.

Commission Conclusion

We reaffirm our decision to codify the determination in KCP&L that the generation dominance standard for market-based sales from new capacity should be dropped. Petitioners have not presented any evidence that demonstrates generation dominance in long-run bulk power markets and, as discussed in Order No. 888, we have found no such evidence of generation dominance in any of the numerous market-based rate cases decided by the Commission since KCP&L. In addition, as described in Order No. 888, the Commission will consider evidence of generation dominance, including generation dominance that results from transmission constraints, when such evidence is presented by an intervenor in a market-based rate case in which a utility seeks market-based pricing associated with new capacity.

American Forest & Paper's argument that the Commission should delay codification of KCP&L until effective competition has been demonstrated to exist in all markets ignores the fact that we have eliminated the

generation dominance standard for market-based rates from new capacity only, and that the generation standard still applies to applications for market-based rates from existing generation. Other entities similarly argue that other markets in which utilities may sell power from new capacity may be highly

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concentrated with respect to generation, or that these utilities may otherwise be able to exert market power. Specifically, TDU Systems and LEPA express concern that the new policy may result in the exercise of market power over very specific bulk power products.

To allay these concerns, we note that eliminating the generation dominance showing applies only to sales from new capacity. It does not apply to entire classes of service or to specific products. In addition, the policy eliminates the showing only as a matter of routine in each filing. We reemphasize that the Commission will consider specific evidence of generation dominance associated with new capacity at the time the seller seeks market-based rates for the new capacity, including whether the addition of the new capacity, when combined with existing capacity, results in generation dominance. This clearly includes situations where existing sources of generation must be combined with new resources to produce a firm power supply. Where entry barriers are a concern, intervenors are free to raise the issue.

SC Public Service Authority also raises a number of concerns relating to the ability of utilities to exercise market power if they are permitted to sell new capacity at market-based rates. These concerns generally include how the Commission determines product and geographic markets, and the standards used to determine whether sellers can exercise market power. In response to these concerns, as noted above public utility owners of new capacity must still seek case-by-case approval before they can sell power from

new capacity at market-based rates and, as stated in the Final Rule, intervenors may present specific evidence that a seller requesting such market rates possesses generation dominance or otherwise has market power.[13] These requirements include considerations of transmission market power, whether other barriers to entry exist and whether there is evidence of affiliate abuse or reciprocal dealing.

b. Market-based Rates for Existing Generation

In the Final Rule, the Commission found that there is not enough evidence on the record to make a generic determination about whether market power may exist for sales from existing generation.[14] The Commission indicated that it would continue its case-by-case approach that allows market-based rates based on an analysis of generation market power in first tier and second tier markets.[15] The Commission further indicated that while it will continue to apply the first-tier/second-tier analysis, it will allow applicants and intervenors to challenge the presumption implicit in the Commission's practice that the relevant geographic market is bounded by the second-tier utilities.

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[13] We do not agree with entities that claim that our decision to rely on evidence raised by intervenors in particular cases with respect to transmission constraints improperly shifts the burden away from the utility, which has the greatest access to information concerning those constraints. Given that we have yet to see any evidence of generation dominance in long-term bulk power markets we do not believe that it is appropriate to burden all market-based rate applicants with significant information requirements as an initial matter. However, if an intervenor raises a specific factual concern with respect to a transmission constraint that may result in the exercise of market power in a particular case, we will examine those facts in a paper or formal hearing. In that context, the utility would be required to come forward with information sufficient to permit a full examination of the effect of the constraint on the applicant's ability to exercise market power.

[14] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,660; *mimeo* at pp. 73-75.

[15] *See, e.g., Southwestern Public Service Company*, 72 FERC ¶61,208, at p. 61,996 (1995), *reh'g pending*.

Finally, the Commission stated that it would maintain its current practice of allowing market-based rates for existing generation to go into effect not subject to refund.[16] To the extent that either the applicant or an intervenor in individual cases offers specific evidence that the relevant geographic market ought to be defined differently than under the existing test, the Commission indicated that it will examine such arguments through formal or paper hearings.

Rehearing Requests

No rehearing requests were filed with respect to this matter.

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B. Legal Authority

In the Final Rule, the Commission responded to commenters challenging the Commission's authority to require open access and reaffirmed its conclusion in the NOPR that it has the authority under the FPA to order wholesale transmission services in interstate commerce to remedy undue discrimination by public utilities.[59]

Rehearing Requests

Authority to Order Open-Access Tariffs

Union Electric challenges the Commission's authority to require wheeling based on arguments that: (1) the rule overlooks the fact that the *AGD* case[60] pertained to voluntary

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16 The Final Rule contained a typographical error in which the word "not" was erroneously omitted.

59 *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,668-79 and 31,686-87; mimeo at pp. 98-129 and 148-51.

60 *Associated Gas Distributors v. FERC*, 824 F.2d 981, 998 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988) (*AGD*).

actions by the pipelines and the Commission's imposition of open-access requirements as a condition on permitting the desired authorizations; (2) the Commission incorrectly treats the *Otter Tail* case;[61] (3) the legislative histories of the NGA and FPA are different and the legislative history of the FPA does not support the Commission's authority to order wheeling; (4) the Commission made prior contrary statements to the U.S. Supreme Court [in its opposition to the grant of certiorari to review the *AGD* decision] about the nature of Commission authority to order open access and judicial construction of that authority in *AGD* and *Otter Tail*;" (5) as a matter of statutory construction, the Commission cannot rely on sections 205 and 206, which are silent as to wheeling, when sections 211 and 212 contain express wheeling provisions; (6) the four relevant cases recognized by the Commission indicate that the Commission may not directly or indirectly order a public utility to wheel or transmit energy for another entity under sections 205 and 206, notwithstanding the Commission's circumscribed ability to order wheeling under sections 211 and 212; (7) prior to the issuance of the Final Rule the Commission, with a full appreciation of the legislative history behind Part II, consistently held that it lacks the authority to order wheeling under FPA Part II; (8) the rule fails to assign "considerable importance" to the Commission's "longstanding interpretation of the statute in accordance with its literal language;" and (9) in legislative hearings preceding enactment of EPAct, the Office of the General Counsel acknowledged

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the limitations on the Commission's wheeling power.

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61 *Otter Tail Power Company v. FPC*, 410 U.S. 366 (1974) (Otter Tail).

Carolina P&L also challenges the Commission's authority to order open-access tariffs, arguing that: (1) *Otter Tail* specifically states: "So far as wheeling is concerned, there is no authority granted the commission under Part II of the Federal Power Act to order it, . . ."; (2) the *Richmond* and *FPL* cases[60] prohibit the Commission from doing indirectly what it cannot do directly; (3) the *AGD* case does not support the Commission's authority to order open access through the filing of generic tariffs—in *AGD* the Commission's authority was based on voluntary actions by the affected pipelines and there are substantial differences between the NGA and the FPA; (4) the legislative history of EPAct indicates that the Commission does not have the authority to mandate open access and can only order open access if section 211 procedures are followed—citing *NYSEG* and *FPL*; and (5) section 211 limits the Commission's authority to order open access on a generic basis—where a specific statute addresses an issue, a more general statute should not be read in a manner that conflicts with the specific statute.

PA Com argues that the Commission's reliance on *AGD* "impermissibly expands the limited holding of *AGD*" and the Commission improperly relied on sections 205 and 206 of the FPA to require open access generically—the Commission only has case-by-case jurisdiction.

VA Com declares that the plain meaning of the FPA and cases interpreting sections 206 and 211 show that the Commission does not have the authority to order industry-wide open access. FL Com and El Paso argue that the Commission only has limited authority to order wheeling and

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[60] *Richmond Power & Light Company v. FERC*, 574 F.2d 610 (D.C. Cir. 1978) (*Richmond*) and *Florida Power & Light Company v. FERC*, 660 F.2d 668 (5th Cir. 1981), *cert. denied sub nom. Fort Pierce Utilities Authority v. FERC*, 459 U.S. 1156 (1983) (*FPL*).

that the Commission has not made the required findings under section 211.[61]

Group Two Section 205 Filings

Union Electric argues that the requirement that Group 2 Public Utilities make section 205 filings is contrary to the voluntary filing scheme inherent in section 205.

Commission Conclusion

Overview

The fundamental legal question before us is the scope of the authority granted to the Commission in 1935 to remedy undue discrimination in interstate transmission services and whether that authority permits us sufficient flexibility to define undue discrimination in light of dramatically changed industry circumstances, in order to provide electricity customers the benefits of more competitively priced power. In the NOPR and Order No. 888, the Commission comprehensively examined case law and legislative history relevant to our authority to order open-access transmission services as a remedy for undue discrimination.[62] We also responded at length in Order No. 888 to arguments that questioned our authority to take this step.[63]

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61 We note that Indianapolis P&L also has made legal arguments regarding our authority to order wheeling under Order No. 888. However, it did so in a request for rehearing of a denial of its request for waiver of the Order No. 888 requirements, not in its request for rehearing of Order No. 888. Accordingly, we will address its arguments when we act on its request for rehearing of its waiver denial.

62 *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,668- 73; *mimeo* at pp. 98-112. Notice of Proposed Rulemaking and Supplemental Notice of Proposed Rulemaking, *FERC Statutes and Regulations* ¶32,514, at pp. 33,053-56 (1995).

63 *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,673- 79; mimeo at pp. 112-129.

On rehearing, as described above, only a few parties continue to question the Commission's authority. As a general matter their rehearings do not raise any arguments, cases, or legislative history not previously considered, and they do not convince us that our action in Order No. 888 is not within our authority under sections 205 and 206 of the FPA. We therefore reaffirm our determination that we have not only the legal authority, but the responsibility, to order the filing of non-discriminatory open-access tariffs if we find such order necessary to remedy

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undue discrimination or anticompetitive effects.

There are several broad points we wish to emphasize in response to the rehearings that have been filed:

First, there is no dispute that the FPA does not *explicitly* give this Commission authority to order, *sua sponte*, open-access transmission services by public utilities. However, the fact remains that the FPA does explicitly require this Commission to remedy undue discrimination by public utilities.[64] The finding of the D.C. Circuit in the *AGD* case, with regard to sections 4 and 5 of the NGA (which parallel sections 205 and 206 of the FPA), are equally applicable here: the Act "fairly bristles" with concerns regarding undue discrimination and it would turn statutory construction on its head to let the failure to grant a general power prevail over the affirmative grant of a specific one.[65]

Second, there also is no dispute that before Congress enacted the FPA in 1935, it rejected provisions that would have explicitly granted the Commission authority to order

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[64] *See FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,669-70; mimeo at pp. 101-03. See *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,669-70; mimeo at pp. 101-03.

[65] 824 F.2d at 998.

transmission to *any* person if the Commission found it "necessary or desirable in the public interest." However, the fact that Congress rejected an extremely broad common carrier provision does not limit the remedies available to the Commission to enforce the undue discrimination provisions in the FPA.[66]

Third, entities on rehearing understandably have focused on statements in case law that indicate limits on the Commission's wheeling authority. They particularly focus on certain statements by the Supreme Court in *Otter Tail*. The Commission in Order No. 888 fully addressed and considered all relevant case law of which we are aware, including statements in *Otter Tail* and other court cases indicating limitations on our authority.[67] We do not dispute these statements and we recognize limitations on our authorities. However, the fact remains that *none* of the cases cited, including *Otter Tail*, involved the issue of whether this Commission can order transmission as a remedy for undue discrimination and *none* addressed industry-wide circumstances such as those before us in Order No. 888.

Fourth, while Congress in 1978 gave the Commission certain case-by-case authority to order transmission access by both public utilities and non-public utilities, and broadened this case-by-case authority in 1992, Congress also specifically provided in section 212(e) of the FPA that the case-by-case authorities were not to be construed as limiting or impairing any authority of the Commission under any other provision of law.[68] Indeed, the legislative history of

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[66] See *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,676-78; mimeo at pp. 120-27.

[67] See *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,668-73; mimeo at pp. 98-110.

[68] See *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,686-87; mimeo at pp. 148-49.

EPAct shows that when Congress amended the section 211-212 wheeling provisions and the section 212(e) savings clause in 1992,[69] it was well aware of arguments regarding the scope of the Commission's wheeling authority as a remedy for undue discrimination under section 206. Whereas Congress in 1992 decided to add a flat prohibition on the Commission ordering direct retail wheeling under *any* provision of the FPA, it did not add a prohibition on the Commission ordering wholesale wheeling to remedy undue discrimination under section 206. It instead retained and modified the savings clause. The issue before us, therefore, hinges on the scope of authority given to this Commission to remedy undue discrimination, not on the scope of authority given to us in 1978 and 1992.

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The Commission is significantly influenced by the decision and case law discussion by the D.C. Circuit in the *AGD* case. This court opinion contains the most recent and comprehensive discussion of the Commission's legal authority to remedy undue discrimination under NGA provisions that mirror those in the FPA, including the relevant case law concerning the Commission's authority to order transmission under the FPA.[70] The rehearing arguments do not, and we believe cannot, reconcile the *AGD* court's discussion and findings with a conclusion that the Commission cannot under any circumstances (as these

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[69] The savings clause in section 212(e) originally provided that no provision of section 210 or 211 shall be treated as "limiting, impairing, or otherwise affecting any authority of the Commission under any other provision of law." In 1992, the 212(e) savings clause was amended to provide that sections 210, 211 and 214 "shall not be construed as limiting or impairing any authority of the Commission under any other provision of law."

[70] *AGD*, 824 F.2d at 996-999. See also *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,668-73, 31,676-78; mimeo at pp. 98-110 and 120-27.

parties advocate) order wheeling under sections 205 and 206 to remedy undue discrimination.

In sum, we believe that the essential question of the Commission's legal authority to impose the requirements of Order No. 888 turns on the flexibility of the Commission's remedial authority under sections 205 and 206 of the FPA to remedy undue discrimination. As was true with respect to the natural gas industry, we acknowledge that Commission precedent for many years nurtured the expectation that we could not, under our authority under the FPA, preclude utilities from using their monopoly power over the nation's transmission systems to secure their monopoly position as power suppliers. However, as described at length in Order No. 888, these policies arose in the context of practical, economic, and regulatory circumstances that gave rise to vertically integrated monopolies and little, if any, competition among power suppliers. In this kind of regime, the interests of customers were most effectively served by the kind of cost-based regulatory regime that has prevailed until very recently. The evolution of third-party generation, facilitated by PURPA and significant technological advances, dramatically altered the economics of power production. The enactment of EPAct recognized these changes and established a national policy intended to favor the development of a competitive generation market, so that the efficiencies of the new marketplace will be available to customers in the form of lower costs for electricity. Utility practices that may have been acceptable a few years ago would, if permitted to continue, smother the fledgling competitive wholesale markets and undermine the efforts of customers to seek lower-price electricity. We firmly believe that our authorities under the FPA not only permit us to adapt to changing economic realities in the electric industry, but also require us to do so, if that is necessary to eliminate undue discrimination and protect electricity customers.

Specific Arguments[71]

The Factual Circumstances Underlying AGD Do Not Mandate a Different Conclusion in This Proceeding

Both Union Electric and Carolina P&L argue that the Commission cannot rely on *AGD* in support of its actions in the electric industry, and they attempt to distinguish the legal basis on which the Commission acted in requiring open-access transportation for gas pipelines. Specifically, they argue that *AGD* (Order No. 436 [*FERC Statutes and Regulations, Regulations Preambles 1982-1985* ¶30,665]) pertained to *voluntary* actions by gas pipelines and that the Commission's imposition of open-access requirements was a *condition* of certificate authorizations to transport gas, whereas the Commission's action in Order No. 888 is a direct mandate.[72] We believe this is a distinction without a difference. While it is true that the Commission required open access as a condition of granting blanket authorizations for pipelines and authorizations for pipelines authorizing pipelines to transport natural gas,[73] the critical point is that in both Order No. 436 and Order No. 888 the Commission's actions hinged as a legal matter on the parallel provisions of the NGA (sections 4 and 5) and the FPA (sections 205 and 206) that prohibit undue discrimination. Whether persons are seeking to transport natural gas or wheel electric power in interstate

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71 We do not repeat our lengthy legal analyses in Order No. 888, but discuss only those arguments that warrant further discussion.

72 See *Union Electric and Carolina P&L*.

73 These authorizations are issued under section 7 of the Natural Gas Act and section 311 of the Natural Gas Policy Act.

commerce, *by law* they must not unduly discriminate or grant undue preference.[74]

In *AGD*, the court upheld the Commission's reliance upon sections 4 and 5 of the NGA to impose an open-access commitment on any pipeline that secured a blanket certificate to provide gas transportation under section 7 of the NGA or provided transportation under section 311 of the NGPA.[75] Order No. 436 was not a simple order that relied on the "voluntary actions" of affected pipelines. As the court in *AGD* understood:

> The Order envisages a complete restructuring of the natural gas industry. It may well come to rank with the three great regulatory milestones of the industry.
>
> . . .
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> At stake is the role of interstate natural gas pipelines. Although they are obviously transporters of gas, they have until recently operated primarily as gas merchants. They buy gas from producers at the wellhead and resell it, mainly to local distribution companies ("LDCs") but also to relatively large end-users. The Commission has concluded that a prevailing pipeline practice—particularly their general refusal to transport gas for third parties where to do so would displace their own sales—has caused serious market distortions. It has found this practice "unduly discriminatory" within the meaning of §5 of the NGA. Order 436 is its response.
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> The essence of Order No. 436 is a tendency, in the industry metaphor, to "unbundle" the pipelines'

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[74] While there is a difference in the statutes in that natural gas transporters must obtain a certificate from the Commission before they can transport gas, there is *no* difference in the statutory standard applied to the interstate service.

[75] 824 F.2d at 997-98. The court also noted the Commission's reliance on section 16 of the NGA.

transportation and merchant roles. If it is effective, the pipelines will transport the gas with which their own sales compete; competition from other gas sellers (producers or traders) will give consumers the benefit of a competitive wellhead market.[76]

Indeed, since Order No. 436 issued, virtually all jurisdictional natural gas pipelines became "open access" transporters of natural gas.

In analyzing the Commission's authority to remedy undue discrimination, the court never made the distinctions now being put forth by Union Electric and Carolina P&L. Rather, the court specifically focused on the Commission's authority under section 5 of the NGA and upheld the Commission's authority to remedy undue discrimination in the transportation of natural gas by requiring pipelines transporting natural gas to do so on a non-discriminatory basis.[77] Similarly, the Commission in Order No. 888 found undue discrimination in the transmission of electric energy and required, pursuant to section 206 of the FPA (the FPA provision that parallels section 5 of the NGA), that if public utilities transmit electric energy in interstate commerce, they must do so on a non-discriminatory basis (i.e., offer non-discriminatory open-access transmission).

Moreover, while the Commission may have imposed a "condition" on pipelines obtaining blanket certificates or providing section 311 transportation in Order No. 436, this does not detract from the court's core finding in *AGD* that the Commission had the authority under section 5 of the NGA to remedy undue discrimination by requiring open-access

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[76] 824 F.2d at 993-94.

77 For example, as the *AGD* court explained with regard to its discussion of *Maryland People's Counsel v. FERC*, 761 F.2d 780 (D.C. Cir. 1985), "we made it clear that blanket-certificate transportation, unconstrained by any nondiscriminatory access provision, might well require remedial action under §5." 824 F.2d at 1000.

transportation.[78] The Commission chose in Order No. 436 to impose its open-access remedy as a condition to pipelines obtaining a blanket certificate to transport natural gas, but its authority was rooted in the undue discrimination provisions

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of section 5. Additionally, the practical result of the conditioning was that all jurisdictional pipelines would have to provide open-access transportation, a result that was clearly anticipated by the *AGD* court.[81] Thus, there is no distinction in the result intended, or the result achieved, in either industry; in both cases, the intent was to remedy undue discrimination pursuant to the statutes governing each industry, and in both cases the result was that all transporters/transmitters must agree to open-access non-discriminatory services if they seek to continue owning, controlling or operating monopoly interstate transportation facilities.

Legislative History Behind the FPA and EPAct Does Not Preclude Our Action

We disagree with the arguments that the legislative history behind Part II of the FPA establishes that the Commission cannot under any circumstance order wheeling under FPA

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[78] We disagree with Union Electric that anything in the Commission's brief to the Supreme Court, opposing certiorari of *AGD*, contradicts our conclusion. We recognize, as the Commission explained in that brief, that there is no equivalent to section 7 of the NGA in the FPA. While this puts Order No. 888 on a somewhat different factual basis from *AGD*, it has no material effect on whether we have the authority to remedy undue discrimination by requiring non-discriminatory open access transmission.

[81] *See* 824 F.2d at 993-94 ("The Order envisages a complete restructuring of the natural gas industry. It may well come to rank with the three great regulatory milestones of the industry. . . .").

sections 205 and 206.[82] We examined the legislative history of sections 205 and 206 at length in the NOPR and Order No. 888 and concluded that it supports our authority to order open-access transmission as a remedy for undue discrimination.[83] We also have examined the legislative history of the EPAct amendments to sections 211 and 212 and conclude that Congress in EPAct did not resolve the issue of our authority under sections 205 and 206 and left untouched whatever pre-existing authorities we had under these sections. The parties have raised nothing new on rehearing to persuade us that our interpretation is wrong. However, there are several arguments that we believe warrant further discussion.

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[82] Parties have raised the legislative history of sections 205 and 206, as well as the legislative history of the EPAct amendments to sections 211 and 212.

[83] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,676- 78; *mimeo* at pp. 120-27. Notice of Proposed Rulemaking and Supplemental Notice of Proposed Rulemaking, *FERC Statutes and Regulations* ¶32,514, at pp. 33,053-56 (1995). Union Electric points to a statement in the Commission's 1987 brief to the U.S. Supreme Court, opposing certiorari of the *AGD* case; in that brief the Commission pointed out that the Supreme Court had noted, in *Otter Tail*, that the legislative histories of the FPA and NGA are "materially different." As we explained in Order No. 888, we have thoroughly reexamined the legislative histories of the NGA and FPA with respect to this issue and now conclude that there is no material difference as to this issue in the legislative histories of the two statutes. Further, such a difference, whether or not it exists, was not crucial to the fundamental holdings of the *AGD* court and does not preclude that decision from applying equally in the electric industry. *See FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,676-78; *mimeo* at pp. 121-26. We also note that in its brief to the Supreme Court the Commission explicitly stated that neither *Otter Tail* nor any of the other electric cases cited "presented the question whether the Commission could order wheeling to remedy undue discrimination or anticompetitive behavior. . . ." FERC Brief at p. 25 (footnote omitted).

Parties on rehearing argue that the existence of sections 211 and 212 limit the Commission's wheeling authority and, in effect, remove our authority under section 206 to order any transmission as a remedy for undue discrimination.[84] We disagree. In enacting EPAct, Congress did not resolve the extent of our wheeling authority outside the context of sections 211 and 212.[85] As we explained above, while Congress in 1978 gave the Commission certain case-by-case authority to order transmission access, it also specifically provided in section 212(e) of the FPA that the case-by-case authorities were not to be construed as limiting or impairing any authority of the Commission under any other provision of law. Congress retained a similar savings clause when it amended sections 211 and 212 in 1992. Moreover, the legislative history of EPAct shows that when Congress amended sections 211 and 212, it was well

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aware of arguments regarding the scope of the Commission's remedial authority under section 206.[86] Whereas Congress added an amendment prohibiting the Commission from ordering direct retail wheeling under *any* provision of the FPA, it chose not to add a prohibition on the Commission ordering wholesale wheeling as a remedy for undue discrimination under sections 205 and 206.[87]

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84 *See* discussion *supra* concerning *AGD* court's understanding that Order No. 436 [*FERC Statutes and Regulations, Regulations Preambles 1982-1985* ¶30,665] was not a simple order that relied on voluntary actions of affected pipelines.

85 Contrary to certain assertions, in Order No. 888 we viewed the statute as a whole and determined that section 211 in no way limited the broad authority Congress gave us to eradicate undue discrimination in the electric power industry.

86 *See* note 71 and related discussion, *supra*.

87 In response to Carolina P&L's argument that Congress gave the Commission a specific remedy under section 211 and the Commission

We are not persuaded that this conclusion is wrong based on rehearing arguments that we ignored other legislative history of EPAct. Carolina P&L argues that we ignored various statements of Senator Wallop following the enactment of EPAct, which it alleges are counter to our claim of authority to order open-access transmission as a remedy for undue discrimination. The utility is simply in error that we ignored these statements. We explicitly mentioned Senator Wallop's statements in Order No. 888 and gave our rationale for why section 211 does not limit our authority to remedy undue discrimination.[88] However, we believe it is important to elaborate on the context in which those statements were made and our interpretation of those statements.

The primary focus of Senator Wallop's statements is on the transmission authority given by the EPAct amendments to sections 211 and 212. These statements emphasize restrictions on our section 211 wheeling authority, including the fact that section 211 does not give the Commission authority to order transmission access on its own motion or to order open-access transmission.[89] We do not quarrel with these statements because sections 211 and 212 clearly do place restrictions on our authority to order access under those

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should not presume that it has additional remedies in such a circumstance, we do not believe that section 211 can credibly be viewed either as a partial substitute for, or as superseding, the section 205-206 undue discrimination remedial authority that is fundamental to the Federal Power Act. Indeed, section 211 is not written in terms of providing remedial authority to address undue discrimination but rather provides for case-by-case transmission service on request if the service is in the public interest and meets the other criteria in sections 211 and 212.

[88] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,686- 87; *mimeo* at pp. 148-51.

[89] Most of the statements talk in terms of "The Conference Report provides . . . ." and thus are referring only to the section 211 and 212 provisions. *See, e.g., 138 Cong. Rec. 517616 (Oct. 8, 1992).*

provisions. The statements also discuss the differences between the House introduced amendments to sections 211 and 212 (which would have provided broader and in some instances mandatory access authority) and the amendments that finally passed (which were more limited). We also do not disagree that changes were made to the bill that originally was introduced. At issue here, however, is not whether there are restrictions on our section 211 authority, but rather whether we have authority *outside the context of section 211* to order transmission as a remedy for undue discrimination. The only statement among Senator Wallop's remarks that addresses this specific issue is one in which he says, "*In my opinion*, neither the amendments made by this Act *nor existing law* give the FERC any authority to mandate open-access transmission tariffs for electrical utilities." (emphasis added). We do not view one senator's opinion as in any way dispositive of the issue. As discussed *supra*, when Congress enacted the 1992 section 211 amendments it was well aware of the outstanding legal issue of the Commission's authority to order access as a remedy for undue discrimination under section 206. It chose not to clarify this issue by prohibiting the Commission from ordering access, but instead retained the savings clause in section 212(e).

The issue of our legal authority thus turns on the undue discrimination authority given to us in 1935, and the legislative history of sections 205 and 206. We discussed this at length in Order No. 888.[90] On rehearing, several entities emphasize the *Otter Tail* case and the legislative history referred to in that case. In particular, Union Electric recites Justice Stewart's discussion of the legislative history in his partial dissent in *Otter Tail*. We do not interpret that discussion to suggest that we do not have the authority to

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90 *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,676- 78; *mimeo* at pp. 120-27.

remedy undue discrimination by requiring open-access transmission under any circumstance. As we explained in Order No. 888:

> In the FPA, while Congress elected not to impose common carrier status on the electric power industry, it tempered that determination by explicitly providing the Commission with the authority to eradicate undue discrimination—one of the goals of common carriage regulation. By providing this broad authority to the Commission, it assured itself that in preserving "the voluntary action of the utilities" it was not allowing this voluntary action to be unfettered. It would be far-reaching indeed to conclude that *Otter Tail*, which was a civil antitrust suit that raised issues entirely unrelated to our authority under section 206, is an impediment to achieving one of the primary goals of the FPA—eradicating undue discrimination in transmission in interstate commerce in the electric power industry.[91]

In response to Union Electric's arguments that Congress explicitly rejected common carrier provisions in 1935, we do not disagree with Union Electric's statement that "the mandatory wheeling language was not dropped inadvertently."[92] The point that we made in Order No. 888 (quoting *AGD*) in this regard was that

> (1) "Congress declined *itself* to impose *common carrier* status" (emphasis added) and (2) there is no "support for the idea that the Commission could under no circumstances whatsoever impose obligations encompassing the core of a common

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[91] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,670; *mimeo* at p. 103.

92 Union Electric at p. 26.

carriage duty." [93]

Nowhere did we ever suggest that the mandatory wheeling language was dropped inadvertently; we simply distinguish a general common carrier obligation imposed "in the public interest" from an obligation to provide transmission service deemed necessary to eliminate undue discrimination. Finally, we fully agree with Union Electric's statement that

> [a]lthough this "first Federal effort" occurred in 1935, the resulting FPA sections 205 and 206 have not been modified in any relevant respect since that time. Therefore, the range of authority conveyed to the Commission in such sections remains the same today as it did then.[94]

We never suggested otherwise and our conclusion in Order No. 888 is not based on a finding to the contrary.

Case Law Does Not Prohibit Our Ordering Wheeling Under Sections 205 and 206 of the FPA

Union Electric, discussing the very cases cited by the Commission in Order No. 888, asserts that "the Commission fails to recognize their dispositive results prohibiting it from ordering wheeling under the sections 205 and 206 of the FPA."[95] We thoroughly examined all of the case law cited by Union Electric, as evidenced by our discussions in the NOPR and Order No. 888, and disagree that any of those cases prohibit the Commission from ordering wheeling under sections 205 and 206 of the FPA to remedy undue

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[93] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,677; *mimeo* at p. 122.

[94] Union Electric at p. 27.

95 Union Electric at p. 30.

discrimination. Indeed, the *AGD* court reached the same conclusion.[96]

Union Electric further cites to a variety of FPC cases that it claims demonstrate that the Final Rule exceeds the Commission's statutory authority.[97] It appears to have proffered every negative Commission statement it could find with respect to our authority to order wheeling under Part II of the FPA. As in the Commission cases cited, we recognize that our authority to order transmission service is not unbounded; if we order transmission, it must be within the scope of authority available to us under the FPA. However, the fact is that none of the cases cited as establishing limits on the Commission's authority addresses the issue before us

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now, i.e., the Commission's authority to order transmission as a remedy for undue discrimination. Simply stated, the Commission has never before been faced with generic findings of undue discrimination in the provision of interstate electric transmission services, and the extent of its authority to remedy that undue discrimination.

The Commission's General Counsel Never Asserted, or Even Suggested, That the Commission Does Not Have the Authority to Order Wheeling as a Remedy for Undue Discrimination

Union Electric spends several pages of its rehearing request asserting that the Commission's own General Counsel has acknowledged the limitations on the

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96 The only relevant case the *AGD* court did not discuss was *NYSEG*. As we explained in Order No. 888, presumably this was because the case did not concern whether the Commission could order wheeling as a remedy for undue discrimination. *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,672 n.217; *mimeo* at p. 108 n.217.

97 Union Electric at pp. 33-37.

Commission's authority to order wheeling.[98] In particular, it points to a statement by a Commission OGC witness that " 'if Congress intends for the Commission to be able to deal with transmission on its own motion and thereby go further than simply dealing with industry proposals,' Congress would need 'to include an affirmative statement somewhere in the Act that the Commission could require wheeling on its own motion.' "[99] This same statement was previously raised by EEI and previously addressed in Order No. 888. We do not disagree that this statement was made. However, it must be read in the context of the witness' entire testimony in which the witness stated *four* times the view that the case law supports the argument that the Commission has authority to order wheeling as a remedy for undue discrimination.[100] Indeed, contrary to Union Electric's assertion, the extensive legal analysis set forth by the Commission's witness supports the position relied upon in this proceeding.[101] Thus, viewed

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98 Union Electric at pp. 37-40.

99 Union Electric at pp. 38-39.

100 Hearings on H.R. 1301, H.R. 1543, and H.R. 2224 before the Subcommittee on Energy and Power of the House Committee on Energy and Commerce, 102d Cong., 1st Sess. (May 1, 2 and June 26, 1991), Statement of Cynthia A. Marlette, Associate General Counsel, Federal Energy Regulatory Commission, Report No. 102-60 at p. 60 ("However, as discussed below, there are strong legal arguments that the Commission's obligation to protect against undue discrimination carries with it the authority to impose transmission requirements as a remedy for undue preference or discrimination." "As discussed below, although the case law in this area has been uncertain, in OGC's opinion there is a strong legal argument that the Commission can require transmission as a remedy for undue preference or undue discrimination."); at pp. 69-70 ("The weight of the limited case law, particularly the *AGD* opinion, supports authority to order wheeling as a remedy for undue discrimination where substantial evidence exists."); at p. 106 ("I believe that we have substantial authority under the existing case law to mandate access where necessary to remedy anticompetitive effects.").

101 The statement quoted was preceded by a legal analysis of the Commission's authorities under then existing law, including section 206,

in the context of the witness' entire testimony. Union Electric's arguments to the contrary are unavailing. Moreover, nowhere did the witness ever suggest, as asserted by Union Electric, that FPA sections 205 and 206 could only be used "to eliminate unduly discriminatory terms in a wheeling arrangement voluntarily filed with the Commission."[102]

The Commission Has the Authority to Order Public Utilities to Make Rate Filings in This Proceeding

We reject Union Electric's argument that our requirement that Group 2 Public Utilities make section 205 filings is contrary to the voluntary filing scheme inherent in section 205. It is true that the Commission ordinarily cannot require a utility to make a section 205 filing. However, in this situation the section 205 filing was required as a remedy under section 206 of the FPA to establish rates for non-discriminatory open-access transmission. Acting pursuant to section 206 of the FPA, we found that undue discrimination exists in the wholesale transmission of electric power and ordered the filing of non-discriminatory open-access transmission tariffs to remedy this discrimination. Section 206 further requires that upon such a finding the Commission "shall determine the just and reasonable rate, charge, classification, rule, regulation,

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practice, or contract to be thereafter observed and in force . . . ." Thus, we had the authority to set the rates that would be

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and a statement that an examination of the Commission's *full* authorities might further open up the industry. Further, it was made in the context of case-by- case industry proposals and the Commission's inability to require case-by-case wheeling on its own motion. It did not address section 206 authority to remedy undue discrimination.

[102] Union Electric at p. 39. We note that Union Electric did not cite to any page or particular language to support its assertion.

observed and in force following the effectiveness of open-access transmission and initially proposed to set rates for each public utility. However, rather than take this intrusive approach, which necessarily would have required a number of generic assumptions and resulted in less than public utility-specific rates, upon issuance of the Final Rule, we chose to permit these public utilities to make section 205 filings to propose their own rates for the services provided in the *pro forma* tariff.

The Commission's Prior Failure to Order Wheeling as a Remedy for Undue Discrimination Is Not Dispositive

After discussing several cases that it asserts address the Commission's authority to remedy undue discrimination, Carolina P&L declares that "[p]erhaps the strongest evidence that the Commission lacks the power to compel wheeling under FPA section 206 is the fact that the Commission has never previously exercised this alleged power, despite numerous opportunities to do so."[103] However, the court in *AGD* succinctly dismissed a similar argument:

> It is finally argued that the Commission's not having imposed any requirements like those of Order No. 436 in the period from enactment in 1938 until the present demonstrates the lack of any power to do so. . . . But as our introductory review of the economic background sought to illustrate, the Commission here deals with conditions that are altogether new. Thus no inference may be drawn from prior non-use.[104]

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[103] Carolina P&L at pp. 35-36.

[104] 824 F.2d at 1001. In this regard, we acknowledge that our view of what constitutes undue discrimination has evolved significantly in light of the dramatic economic changes in the industry, as described briefly above and more fully in Order No. 888.

Undue Discrimination/Anticompetitive Effects [105]

A number of utilities and state commissions argue that the Commission lacks evidence to support a finding of undue discrimination.[106]

VA Com argues that the Commission failed to make a legally supportable finding of industry-wide undue discrimination: "FERC apparently drew a conclusion that there was undue discrimination in the NOPR without support and later accepted customers' allegations, without further inquiry, and relied on them in making its finding of industry-wide undue discrimination." (VA Com at pp. 2-3).

PA Com and Carolina P&L assert that allegations of undue discrimination do not form a sufficient basis to compel a generic rulemaking. Not coming forward with specific accusations and the identity of specific accusers, PA Com asserts, is unconstitutional as a deprivation of due process.

With regard to specific allegations of undue discrimination, SoCal Edison argues that the Commission inappropriately relied upon allegations involving SoCal Edison as evidence of undue discrimination. SoCal Edison asks that the Commission declare that it is not making a factual determination as to any particular allegation especially since prior to 1994 the Commission defined discrimination differently. Dalton similarly argues that the Commission has no basis for finding that Georgia Power Company is engaged in unlawful undue discrimination as to new or roll-over transmission services in the operation of the Integrated Transmission System in Georgia (ITS) under the ITS agreement. Moreover, Dalton argues, even if it is found that GPC acted in unduly discriminatory manner, it is not

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105 *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,682- 84; *mimeo* at pp. 136-42.

106 *E.g.*, El Paso, Union Electric, Carolina P&L, VA Com, FL Com, PA Com.

practical or lawful to order open-access tariff for new and roll-over services.

Finally, Carolina P&L argues that the comparability standard does not eliminate the "requirement" that parties must be similarly situated before discrimination is present, and that the Commission has not provided factual support for its implicit finding that public utilities and their native load customers are similarly

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situated to third parties. It cites *City of Vernon v. FERC*, 845 F.2d 1042 at 1045-46 (D.C. Cir. 1988), in support.

Commission Conclusion

As an initial matter, the Commission grants SoCal Edison's request for clarification that in Order No. 888 we did not make a factual determination as to any particular allegation of past discrimination described in the Final Rule.[107] However, we reject arguments that the Commission cannot rely in part on the array of allegations and circumstances raised by customers in individual cases over the years and brought forth in response to the NOPR. The specific allegations are illustrative. However, they present examples of the types of discriminatory incentives and behavior inherent in ownership of monopoly transmission facilities, and also present credible examples of the types of discriminatory behavior in which public utilities could engage in the future. We also reject arguments that customers and the Commission must litigate and make specific findings of discrimination against each public utility before we can

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[107] In response to PA Com's and Carolina P&L's assertions that not coming forward with specific accusations and identities of specific accusers is unconstitutional and a deprivation of due process, we emphasize that the Commission has not denied due process to anyone. The Final Rule does not, nor is it intended to, make specific findings as to any particular utility or any particular allegation raised.

take any action to preclude discriminatory behavior that will harm competition and, ultimately, electricity consumers. This is particularly true where the discriminatory behavior clearly is in the economic self-interest of a monopoly transmission owner facing the markedly increased competitive pressures that are driving today's electric utility industry. As we recognized in Order No. 888,

> [t]he inherent characteristics of monopolists make it inevitable that they will act in their own self-interest to the detriment of others by refusing transmission and/or providing inferior transmission to competitors in the bulk power markets to favor their own generation, and it is our duty to eradicate unduly discriminatory practices. As the *AGD* court stated: "Agencies do not need to conduct experiments in order to rely on the prediction that an unsupported stone will fall."[108]

We believe that the same general discriminatory circumstances that faced us when we required open-access transportation in the natural gas industry[109] are also before us today in the electric industry. First, it is uncontested that market power continues to exist in the ownership and operation of the monopoly-owned facilities that comprise the nation's interstate transmission grid. Second, utilities, as a general matter, did not in the past offer comparable transmission services to competitors or to customers. Open-access services simply were not made available by utilities until the late 1980s when the Commission began to impose open access as a condition of approval of market-based rates and utility mergers in order to mitigate market power and remedy anticompetitive effects. Rather, the vast majority of

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[108] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 331,682; *mimeo* at pp. 136-37.

[109] *See AGD*, 824 F.2d at 999-1000.

utilities historically have declined to transport electric energy that would compete with their own sales or have offered access that is inferior to what they use for their own sales. Third, discrimination in transmission services, when viewed in light of utilities' own uses of their transmission systems compared to what they offer third parties, has denied and will continue to deny customers access to electricity at the lowest reasonable rates. The entities on rehearing have raised nothing to persuade us that it is in the interests of consumers to maintain the self-evident incentives for transmission owners to exercise their monopoly power over transmission to discriminate in favor of their own generation sales—incentives that will only increase in the future as competitive pressures continue to escalate.

The Commission addressed the same argument as that being made by Carolina P&L, that the Commission has not made the requisite finding that third-party transmission customers are similarly situated to public utilities and their native load customers, in 1994 in the *NEPOOL*

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and *AEP* cases.[110] In these cases, we recognized that the traditional focus of our undue discrimination analysis had been whether factual differences justify different rates, terms and conditions for similarly situated customers, but concluded that due to changing conditions in the electric utility industry, it was necessary to reevaluate our traditional analysis. As we stated in *NEPOOL*, the focal point of undue discrimination claims has shifted from claims of undue discrimination in rates and services which the utility offers different customers to claims of undue discrimination in rates and services which the utility offers when compared to its

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[110] *New England Power Pool*, 67 FERC ¶61,402 (1994) (*NEPOOL*); *American Electric Power Service Corporation*, 64 FERC ¶61,279 (1993), *reh'g granted*, 67 FERC ¶61,168, *clarified*, 67 FERC ¶61,317 (1994) (*AEP*).

own use of the transmission system.[111] "In this context, framing the analysis in terms of how a public utility treats similarly situated customers is not applicable or instructive."[112] The Commission concluded that it therefore must reexamine its application of the standard for undue discrimination claims under sections 205 and 206 of the FPA.

The Commission further elaborated on its re-examination of undue discrimination in *AEP*. The Commission cited its *NEPOOL* discussion and set for hearing the different uses that AEP made of its transmission system and whether there were any operational differences between any particular use that AEP made of the system and the use third parties might need, and, in particular, the degree of flexibility AEP accorded itself in using its transmission system for different purposes. The Commission subsequently set the same issue for hearing in several other cases.[113] In the NOPR, however, the Commission concluded that based on what it had learned in the ongoing cases, it would address this issue generically in this rulemaking. We announced in the NOPR our belief that all utilities use their own systems in two basic ways: to provide themselves point-to-point transmission service that supports coordination sales, and to provide themselves network transmission service that supports the economic dispatch of their own generation units and purchased power resources (integrating their resources to meet their internal load). Third parties may need one or both of these basic uses in order to obtain competitively priced generation or to have the opportunity to be competitive sellers of power, and the Commission proposed that all

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111 67 FERC ¶61,042, at p. 61,132.

112 *Id.*

113 *Commonwealth Edison Co.*, 70 FERC ¶61,204 (1995); *Wisconsin Electric Power Co.*, 70 FERC ¶61,074 (1995); and *Wisconsin Public Service Corp.*, 70 FERC ¶61,075 (1995).

public utilities must offer both services on a non-discriminatory open-access basis.[114]

We affirmed this determination in the Final Rule. We concluded that a public utility must offer transmission services that it is reasonably capable of providing, not just those services that it is currently providing to itself or others. Because a public utility that is reasonably capable of providing transmission services may provide itself such services at any time it finds those services desirable, it is irrelevant that it may not be using or providing that service today.[115] Thus, based on the analysis in this record, the Commission has determined that undue discrimination in the provision of transmission services in today's industry does not turn on whether utilities and their native load customers are similarly situated to third parties, but instead turns on whether the utility is providing comparable service, that is, service that it is reasonably capable of providing to other users of the interstate transmission system.

In short, the Commission is not bound to a static application of its undue discrimination analysis under the FPA and, indeed, has a public interest responsibility to reexamine undue discrimination in light of changed circumstances in the industry.[116] That is what we began in *NEPOOL* and *AEP* and have completed in this rulemaking. The traditional "similarly

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114 *FERC Statutes and Regulations* ¶32,524, at p. 33,079.

115 *FERC Statutes and Regulations* at p. 31,690; *mimeo* at p. 160.

116 There is no "requirement" in the FPA that the Commission apply a "similarly situated" test. Carolina P&L's reliance on *City of Vernon* is misplaced. That case involved a claim of discrimination in the type of service offered to a wholesale customer versus that offered to retail customers, and the Commission's application of the "similarly situated" and "same service" test. Contrary to Carolina P&L's implication, the case does not hold that the Commission is bound to apply a "similarly situated" test in analyzing undue discrimination claims under the FPA.

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situated" test, while applicable to discrimination among third-party customers, simply is not applicable when analyzing discrimination between third-party transmission customers and transmission owners. Under Carolina P&L's theory, presumably the only customers that could be shown to be similarly situated would be those who own monopoly transmission facilities and have native load (i.e., captive) customers. This would preserve customer captivity, perpetuate monopoly power and profits, and deny the lowest reasonable rates to consumers. We therefore reject Carolina P&L's arguments.

Moreover, the fact that public utilities and their native load customers have been treated differently from third-party transmission customers because they are not among those traditionally considered to be "similarly situated" is precisely the target at which Order No. 888 takes aim. Historically, competitively-priced power was not broadly available to wholesale customers because the industry was dominated by vertically integrated IOUs[117] and, to the extent cheaper generation alternatives were available in the marketplace, transmission owners either took the cheaper power for their own uses or purchased and re-sold it at a profit.[118] Prior to EPAct, most power customers took power from the vertically integrated utilities that provided their transmission service. Transmission-only transactions played a secondary role in bulk power markets, facilitating certain economy transactions and coordination and pooling arrangements that improved

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[117] *I.e.*, investor-owned utilities that owned generation, transmission and distribution facilities and most of whom had captive customers.

[118] Very simply, the transmission owner was able to prevent third parties from achieving the maximum savings possible in the generation market by withholding or delaying transmission service. Alternatively, the transmission owner could purchase the power and resell it to the third party at a rate that reflected a mark-up from the first power sale.

utility operational efficiencies, largely as a complement to bundled bulk power transactions. Given the predominantly vertically-integrated industry and efficiencies that could be gained through encouragement of coordination and pooling transactions, the Commission was willing to accept utility practices that provided third parties with transmission services that were distinctly inferior to the utility's own uses of the transmission system.

In the future, however, unbundled transmission service will be the centerpiece of a freely traded commodity market in electricity, in which all wholesale customers can shop for power. In a market characterized by a significant increase in non-vertically integrated power suppliers and competitively priced power that is now meaningfully available, it is no longer in the interest of wholesale customers for the Commission to tolerate the types of practices that were previously accepted. We cannot allow what have become unduly discriminatory practices to erect barriers between customers and the rapidly emerging competitive electricity marketplace. Accordingly, a primary goal of Order No. 888 is to provide that in the future transmission providers and third-party transmission customers are "similarly situated" in the quality of transmission service available to them.

C. Comparability

1. Eligibility to Receive Non-discriminatory Open-Access Transmission

In the Final Rule, the Commission modified the definition of "eligible customer" and, among other things, clarified that any entity engaged in wholesale purchases or sales of electric energy, not just those "generating" electric power, is eligible.[119] The Commission also clarified that entities that would violate section 212(h) of the FPA

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[119] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,688- 90; *mimeo* at pp. 154-58.

(prohibition on Commission-mandated wheeling directly to an ultimate consumer and sham wholesale transactions) are not eligible. Further, the Commission clarified that foreign entities that otherwise meet the eligibility criteria may obtain transmission services. The

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Commission also provided for service to retail customers in circumstances that do not violate FPA section 212(h). Persons that would be eligible section 211 applicants also would be eligible under the open-access tariff.

a. Unbundled Retail Transmission and "Sham Wholesale Transactions"

Rehearing Requests

Several entities assert that there is an inconsistency between tariff language and preamble language and argue that section 1.11 of the tariff should be made consistent with the preamble to ensure that, absent a state-approved program, retail wheeling is not available under the tariff, no matter which party requests service.[120] They maintain that the limitation in section 1.11 that the transmission provider only must provide retail transmission service voluntarily or under a state-approved program appears to apply only when a retail customer is the purchaser, not when the transmission purchaser is an electric utility. They suggest the following language to remedy the problem: "however, such entity is not eligible for transmission service that would be prohibited by sections 212(h)(1) and/or 212(h)(2) of the Federal Power Act, unless such service is provided pursuant to a state retail access program or pursuant to a voluntary offer of unbundled retail transmission service by the Transmission Provider." (PSE&G at p. 22; Carolina P&L at pp. 8-9).

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120 *E.g.*, SoCal Edison, PSE&G, Carolina P&L.

Detroit Edison argues that the Commission should modify the definition to exclude any reference to transmission service provided to retail customers so as to avoid confusion and possible forum shopping. At the least, Detroit Edison argues, the Commission should modify the language to state that transmission service is available to an ultimate consumer to the extent, and only to the extent, that the service is authorized by a lawful state retail access program or pursuant to a voluntary offer of unbundled retail transmission service by the transmission provider.

NYSEG asserts that the Commission did not apply the section 212(h) limitation to service to retail customers under the tariff. NYSEG requests that the Commission clarify that it will not require retail wheeling beyond the scope of state-mandated retail access programs or beyond the terms of a transmission provider's voluntary offer of retail wheeling service.

Oklahoma G&E asks the Commission to clarify that the term eligible customer differentiates between a customer eligible to receive transmission service and a customer whose transaction is a sham or would result in mandatory retail wheeling and would therefore be prohibited by section 212(h).

NYSEG further asserts that the right of first refusal provision would permit a retail customer receiving wheeling service to continue to take that service upon expiration of its contract, which could require the transmission provider, in violation of section 212(h), to continue retail wheeling beyond the scope of its voluntary offer of service or beyond the scope of a state-mandated retail access program.

SoCal Edison argues that the Commission cannot compel a utility to supply retail transmission service if the utility challenges the authority of the state to require retail wheeling and section 1.11 should be revised to reflect this.

IL Com declares that it "does not recognize FERC's claim of jurisdiction over retail transmission service provided directly to a retail customer and disputes that unbundled retail wheeling directly to a retail customer is a service provided in interstate commerce." (IL Com at p. 35). Thus, "if FERC's proposed 'deference' to states is to be given any effect, states must be allowed to determine whether the retail transmission component of the retail wheeling program will be provided pursuant to the utility's existing filed wholesale tariff or whether the retail transmission will be provided pursuant to a 'separate retail transmission tariff' that is different from the wholesale tariff." (IL Com at p. 36). IL Com concludes that it is inappropriate (and illegal if FERC is overturned on its retail transmission jurisdiction assertion) to include retail customers taking final delivery of unbundled power for their own end-uses under retail wheeling programs as eligible customers.

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PA Com argues that it is relevant whether a customer is receiving retail or wholesale service and redefining transmission and local distribution service does not automatically convey jurisdiction to the Commission.

CCEM asks that the Commission clarify that a retail customer eligible to seek transmission service should be able to seek transmission service not only from the transmission provider, but from any other transmission provider. CCEM also asks that the Commission add the word "ultimate" before the word transmission provider in section 1.11 of the tariff.

EEI asks the Commission to "clarify that the transmission service provider should be allowed to supplement the terms and conditions of the *pro forma* tariff with additional provisions that specifically relate to the *totality* of the transmission service being provided, including the use of distribution facilities and any other transmission

facilities not currently included in wholesale rates." (EEI at p. 24 (emphasis in original)).[121]

Union Electric argues that a literal reading of the eligibility definition could require retail wheeling by utilities in states other than those required to participate in a particular retail wheeling program.

Commission Conclusion

The Commission agrees with those entities that argue that section 1.11 of the *pro forma* tariff does not explicitly prohibit "sham wholesale transactions" that could currently be arranged under the tariff by a utility applying for service and designating the retail customer as a point of delivery. We therefore have modified section 1.11 to clarify that, with respect to service that we are prohibited from ordering by section 212(h) of the FPA (whether direct retail wheeling or "sham" wholesale wheeling), otherwise eligible entities may obtain such service under the tariff only if it is pursuant to a state requirement that such service be provided or pursuant to a voluntary offer of such service. We also have modified the language to clarify that eligibility for unbundled direct retail service required by a state applies only to service from transmission providers that the state orders to provide the service. The modified language states:

> Eligible Customer: (i) Any electric utility (including the Transmission Provider and any power marketer), Federal power marketing agency, or any person generating electric energy for sale for resale is an eligible customer under the tariff. Electric energy sold or produced by such entity may be electric energy produced in the United States, Canada, or Mexico. However, with respect to transmission service that the Commission is prohibited from ordering by section 212(h) of the Federal Power

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121 *See also CSW Operating Companies.*

> Act, such entity is eligible only if the service is provided pursuant to a state requirement that the Transmission Provider offer the unbundled transmission service, or pursuant to a voluntary offer of such service by the Transmission Provider. (ii) Any retail customer taking unbundled transmission service pursuant to a state requirement that the Transmission Provider offer the transmission service, or pursuant to a voluntary offer of such service by the Transmission Provider, is an eligible customer under the tariff.

Regarding SoCal Edison's argument, the Commission stated in the Final Rule:

> Moreover, we are mindful of the fact that we are precluded under section 212(h) from ordering or conditioning an order on a requirement to provide wheeling directly to an ultimate consumer or sham wholesale wheeling. We therefore clarify that our decision to eliminate the wholesale customer eligibility requirement does not constitute a requirement that a utility provide retail transmission service. Rather, we make clear that if a utility chooses, or a state lawfully requires, unbundled retail transmission service, such service should occur under this tariff unless we specifically approve other terms.[122]

Therefore, the Commission is not compelling a utility to provide unbundled retail transmission service.[123] Rather, the Commission

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[122] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,689- 90; *mimeo* at p. 158.

123 We also disagree with NYSEG's assertion that the right of first refusal provision would permit a retail customer receiving wheeling service to continue to receive service after the expiration of its contract and could require the transmission provider to continue wheeling beyond

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requires that should such service be provided, either pursuant to state mandate or voluntarily, it must be provided pursuant to the *pro forma* tariff unless the Commission approves alternative terms and conditions.

However, in light of CCEM's request that we clarify that a retail customer eligible to seek transmission service under the tariff should be able to seek service not only from the transmission provider, but also from any other transmission provider, and in light of Union Electric's concerns regarding retail service eligibility, we believe certain clarifications of our jurisdiction and of the statements made in Order No. 888 are necessary. The statements cited above that were made in Order No. 888 and the eligible customer tariff definition in (ii) above refer to direct retail transmission, i.e., the transmission of electric energy "directly" to an ultimate consumer. The Commission is prohibited by section 212(h)(1) of the FPA from ordering this type of retail transmission and that is why customers are eligible for such transmission under the tariff only if the transmission is pursuant to a state order or is provided voluntarily. However, on its face, section 212(h) does not prohibit the Commission from ordering public utilities to provide "indirect" unbundled retail transmission in interstate commerce, i.e., the transmission necessary to transmit unbundled electric energy to a utility that ultimately will deliver the energy to a customer that is purchasing the unbundled energy at retail either pursuant to a state retail access order or pursuant to voluntary delivery by the local utility.

We clarify that we believe we have the jurisdiction under the FPA to order indirect retail transmission to an ultimate

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the scope of its voluntary offer of service or beyond the scope of a state-mandated retail access program. Section 212(h) of the FPA would override any provision, including the right of first refusal provision, that may be included in the *pro forma* tariff.

consumer and that if the Commission under sections 205, 206 or 211 of the FPA orders such transmission, entities that otherwise qualify as eligible customers under the tariff will take transmission service for such indirect retail wheeling pursuant to the *pro forma* tariff. We note that the Commission may order such transmission on a case-by-case basis or may determine to do so generically in the future. We expect public utilities to provide such indirect retail access under the *pro forma* tariff and, if they do not, we will not hesitate to order them to do so.

In response to IL Com's argument that it does not recognize this Commission's claim of jurisdiction over the rates, terms and conditions of unbundled retail transmission that is provided directly to an ultimate consumer, the Commission reaffirms its legal conclusion set forth in the Final Rule.[124] As to its claim that we should give deference to the state as to whether such service could be taken under the wholesale tariff or a separate retail tariff on file with the Commission, we reaffirm our conclusion to address this on a case-by-case basis. Since the Final Rule issued, the Commission has addressed this in several orders. In *New England Power Company*, the Commission stated:[125]

> As we explained in the Open Access Rule and in the New Hampshire Interim Order, we generally expect retail transmission customers to take service under the same Commission tariff that applies to wholesale customers. While we generally will defer

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[124] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,780 and appendix G (at pp. 31,966-81); *mimeo* at p. 428 and appendix G.

[125] 75 FERC ¶61,356 at p. 62,141, *order on reh'g*, 77 FERC ¶61,135 (1996). In the order on rehearing, the Commission permitted a separate retail tariff to remain in effect for the duration of the retail electric pilot programs established in Massachusetts by Massachusetts Electric Company.

> to state requests for a separate retail tariff to accommodate the design and special needs of a state retail access program, the Massachusetts Commission has made no such request in this case.[15]

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[15] *See* Open Access Rule, *FERC Statutes and Regulations*, at p. 31,784; *New Hampshire Interim Order*, 75 FERC at p. 61,687 & n.3 (both noting that such a separate retail tariff must

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be consistent with the Commission's open-access policies and comparability principles) . . . .

Subsequently, in *New England Power Company*, 76 FERC ¶61,008 (1996), the Commission granted a limited waiver of the Open Access Rule requirements for the New Hampshire retail electric competition pilot project. Specifically, the Commission waived the requirement for individual service agreements, and the requirement for customer deposits. The Commission further announced that:

> other public utilities that provide unbundled retail service under a *pro forma* tariff do not need to apply to retail customers the tariff provisions regarding individual service agreements or customer deposits, unless a state retail program so requires. [126]

Concerning EEI's request for clarification, the Commission stated in the Final Rule:

> all tariffs need not be "cookie-cutter" copies of the Final Rule tariff. Thus, under our new procedure, ultimately a tariff may go beyond the minimum elements in the Final Rule *pro forma* tariff or may account for regional, local, or system-specific

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[126] 76 FERC at p. 61,024.

> factors. The tariffs that go into effect 60 days after publication of this rule in the *Federal Register* will be identical to the Final Rule *pro forma* tariff; however, public utilities then will be free to file under section 205 to revise the tariffs, and customers will be free to pursue changes under section 206. [127]

Utilities are free to include customer-specific terms and conditions or terms and conditions limited to certain customers (*e.g.*, a distribution charge) in the customer's service agreement and/or the network customer's network operating agreement.

b. Transmission Providers Taking Service Under Their Tariff

Rehearing Requests

TAPS states that section 1.11 does not seem to require a transmission provider to take service for its purchases, but the preamble does (citing *mimeo* at pp. 57, 191, 266 and regulatory text in section 35.28(c)(2)). It argues that transmission providers should be required to treat their own usage of the transmission system to serve retail customers under the network service provisions of the tariff. TAPS argues that this result could be achieved through an ISO or by requiring transmission providers to abide by all non-price terms of Parts I and III of the tariff. TAPS also argues that the rates charged network customers must be developed on the same basis as the transmission component of retail rates. It states that the transmission provider's purchases would then be made under Part III of the tariff to the extent they are made for serving retail customers. It further asserts that the Commission's authority and obligation to consider transmission owners' service to retail load in establishing wholesale transmission rates has been long established. At

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[127] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,770 n.514; *mimeo* at p. 399 n.514.

the least, TAPS argues that the Commission should require that a transmission provider take its wholesale purchases under some tariff.

Similarly, Coalition for Economic Competition asks the Commission to clarify that the requirement to use the *pro forma* tariff for wholesale purchases and to functionally unbundle wholesale purchases and sales does not apply to purchases made solely to serve retail customers on a bundled basis. It asserts that there is conflicting language in Order No. 888 (citing *mimeo* at p. 191) and Order No. 889 (citing *mimeo* at p. 12) and the *pro forma* tariff. Coalition for Economic Competition asserts that the Commission does not have jurisdiction over transmission that is part of a bundled retail sale.

Commission Conclusion

Several parties have noted on rehearing that there is conflicting language among the Final Rule, Order No. 889 and the *pro forma* tariff as to whether and to what extent the transmission provider must take service for "wholesale purchases" under its own tariff. As discussed below, we clarify that a transmission provider does not have to "take service" under its own tariff for the transmission of power

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that is purchased on behalf of bundled retail customers.

In a situation in which a transmission provider purchases power on behalf of its retail native load customers, the Commission does not have jurisdiction over the transmission of the purchased power to the bundled retail customers insofar as the transmission takes place over such transmission provider's facilities,[128] and therefore the *pro*

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[128] To the extent the transmission takes place on the interstate facilities of other public utilities, we would have jurisdiction over such transmission.

forma tariff does not have to be used for such transmission. Moreover, we recognize that purchases made collectively on behalf of native load[129] cannot necessarily be identified as going to any particular customer. However, the Commission does have jurisdiction over transmission service associated with sales to any person for resale, and such transmission must be taken under the transmission provider's *pro forma* tariff.[130]

Order No. 888, relying on the principle of comparability, established the terms and conditions for network service provided to network customers under the *pro forma* tariff. Network customers may include the transmission provider itself as well as any other entity receiving Network Integration Service. If the transmission provider purchases energy from another power supplier in order to make sales to its wholesale native load customers, it must take the transmission service necessary to transmit the power from its point(s) of receipt to its point(s) of delivery under the same terms and conditions as other Network Customers.[131] As we explained in *AES Power, Inc.*, network customers are entitled to make economy energy purchases from non-designated

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[129] Native load means "[t]he wholesale and retail power customers of the Transmission Provider on whose behalf the Transmission Provider, by statute, franchise, regulatory requirement, or contract, has undertaken an obligation to construct and operate the Transmission Provider's system to meet the reliable electric needs of such customers." Section 1.19 of the *pro forma* tariff.

[130] All transmission in interstate commerce by a public utility in conjunction with a sale for resale of electric energy is jurisdictional and must be taken under a FERC-jurisdictional tariff. The same is true for all unbundled transmission in interstate commerce to wholesale customers, as well as to unbundled retail customers.

[131] Under the Order No. 888 *pro forma* tariff, third-party wholesale customers have the ability to obtain the identical service the transmission provider provides itself when it engages in a sale of electric energy for resale. This may include network or point-to-point service.

network resources at no additional charge on a basis comparable to the economy energy purchases made by the transmission provider on behalf of its bundled retail customer.[132] This applies to the transmission provider as a network transmission customer under its own tariff as well as to other network transmission customers that make economy energy purchases on behalf of their customers. Thus, insofar as all wholesale transmission customer usage is concerned, third-party network customers are treated the same as the transmission owner.

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8. Consequences of Functional Unbundling

a. Distribution Function

In the Final Rule, the Commission concluded that the additional step of functionally unbundling the distribution function from the transmission function is not necessary at this time to ensure non-discriminatory open-access transmission.[155]

Rehearing Requests

No requests for rehearing addressed this matter.

b. Retail Transmission Service

In the Final Rule, the Commission explained that although the unbundling of retail transmission and generation, as well as wholesale transmission and generation, would be helpful in achieving comparability, it did not

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[132] 69 FERC ¶61,145, at p. 62,300 (1994) (proposed order), 74 FERC ¶61,220 (1996) (final order).

[155] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,699; *mimeo* at p. 186.

believe it was necessary.[156] The Commission further explained that the matter raises numerous difficult jurisdictional issues that are more appropriately considered when the Commission reviews unbundled retail transmission tariffs that may come before the Commission in the context of a state retail wheeling program.

Rehearing Requests

CCEM argues that all transmission must be unbundled, including currently bundled retail transmission service, because failure to do so is inconsistent with the Commission's assertion of jurisdiction over the rates, terms, and conditions of unbundled interstate transmission to retail customers and authority to address retail stranded costs through its jurisdiction over such costs. CCEM notes that the Commission found it necessary in Order No. 636 to unbundle the pipeline's direct retail sales to achieve comparability (CCEM cites *FPC v. Conway Corp.*, 426 U.S. 271, 273 (1976) and *Mississippi River Transmission Corp. v. FERC*, 969 F.2d 1215 (D.C. Cir. 1992) for the proposition that the Commission has jurisdiction over all interstate transmission).

NY Municipal Utilities and American Forest & Paper also argue that the Commission erred in not requiring the unbundling of the transmission component of *retail* sales. American Forest & Paper believes that such unbundling will facilitate competition by making the generation price transparent to all participants.

Commission Conclusion

We disagree with those entities that argue that the Commission erred in not requiring the unbundling of all transmission service, including the unbundling of transmission from retail service. As we explained in the Final Rule:

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[156] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,699- 700; *mimeo* at p. 188.

> when transmission is sold at retail as part and parcel of the delivered product called electric energy, the transaction is a sale of electric energy at retail. Under the FPA, the Commission's jurisdiction over sales of electric energy extends only to wholesale sales. However, when a retail transaction is broken into two products that are sold separately (perhaps by two different suppliers: an electric energy supplier and a transmission supplier), we believe the jurisdictional lines change. In this situation, the state clearly retains jurisdiction over the sale of the power. However, the unbundled transmission service involves *only* the

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> provision of "transmission in interstate commerce" which, under the FPA, is exclusively within the jurisdiction of the Commission. Therefore, when a bundled retail sale is unbundled and becomes separate transmission and power sales transactions, the resulting transmission transaction falls within the Federal sphere of regulation.[157]

Nor is our decision not to unbundle transmission from retail generation service inconsistent with our assertion of jurisdiction over unbundled interstate transmission to retail customers. As we explained in the Final Rule and described further above, we have exclusive jurisdiction under the FPA over "transmission in interstate commerce" by public utilities, which includes the unbundled interstate transmission

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[157] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,781; *mimeo* at pp. 430-31 (emphasis in original). As discussed in section IV.I., *infra*, we believe this jurisdictional determination is supported by the statute and the case law, including the D.C. Circuit's recent decision in *United Distribution Companies v. FERC*, 88 F.3d 1105 (1996).

component of a previously bundled retail transaction.[158] Our assertion of jurisdiction in such a situation arises only if the retail transmission in interstate commerce by a public utility occurs voluntarily or as a result of a state retail program.

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3. Curtailment and Interruption Provisions[297]

a. Pro-Rata Curtailment Provisions

In the Final Rule, the Commission found that curtailment on a pro-rata basis is appropriate for curtailing transactions that substantially relieve a constraint.[298] The Commission explicitly allowed the transmission provider discretion to curtail the services, whether firm or non-firm, that substantially relieve the constraint.

The Commission also indicated that it would consider granting deference to an alternative curtailment method to avoid hydro spill if such a regional practice is generally accepted and adhered to across the region.

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158 *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,781; *mimeo* at p. 431.

297 In the Final Rule pro forma tariff, the Commission defines curtailment as: "A reduction in firm or non-firm transmission service in response to a transmission capacity shortage as a result of system reliability conditions." (pro forma tariff section 1.7). The pro forma tariff defines interruption as: "A reduction in non-firm service due to economic reasons pursuant to section 14.7." (pro forma tariff section 1.15). The distinction between curtailment and interruption may have been blurred in Order No. 888 and this order attempts to clarify that distinction.

298 *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,749; *mimeo* at pp. 335-36.

The Commission further found that under network and point-to-point service, the transmission provider may propose a rate treatment (penalty provision) to apply in the event a customer fails to curtail service as required under the Final Rule pro forma tariff and indicated that such proposals will be evaluated on a case-by-case basis on compliance.

Rehearing Requests

PA Com asserts that pro rata curtailment fails to hold native load harmless to the extent practical as required by the FPA. PA Com points out that on January 19, 1994, PJM initiated pro-rata load shedding, in part to preserve economic transactions, leaving customers in Pennsylvania without power during a record cold spell.

VA Com argues that pro rata curtailment may harm native load customers and section 206 complaints are after the fact and of little assistance to native load. VA Com argues that curtailment priority (in order of curtailment) should be: non-firm, contract firm, and then native load, and that utilities should have flexibility to curtail on a pro-rata basis within classes, subject to state curtailment policy.

Several entities argue that provision must be made for preference in curtailment priorities obtained through settlement, through payment of good and valuable consideration, or under existing transmission contracts.[299] Turlock argues that customers should be able to obtain a variation from the pro rata scheme if they can show that they have made either past or future investments to improve constrained facilities and that the quid pro quo for their investment is improved curtailment priority.

Allegheny asks the Commission to clarify that it did not intend to require public utilities to shed (through pro rata curtailment) native transmission load customers in order to

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299 *E.g.*, Santa Clara, Redding, TANC.

preserve some portion of service to through system users of the grid. According to Allegheny, the FPA mandates that service reliability to franchise customers must be maintained and through-system users are not similarly situated to native transmission load customers and should not be treated the same in an emergency because through system customers can protect themselves, but native transmission load customers cannot. Allegheny adds that failure to maintain system reliability would violate section 211 of the FPA.

CCEM asserts that hard and fast priority rules are needed to prevent inconsistent rules from developing for different utilities, pools, or control areas.

Commission Conclusion

Assertions that the pro-rata curtailment provision in the tariff may harm native load customers are misplaced. The Commission clarified in the Final Rule that it was not requiring a pro-rata curtailment of all transactions at the time of a constraint, but rather curtailment of

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those transactions, whether firm or non-firm, that effectively relieve the constraint.[300] The Commission also required that such curtailments be made on a non-discriminatory basis, including the transmission provider's own wholesale use of the system. The Commission further explained that the pro-rata curtailment provision was intended to apply to situations where multiple transactions could be curtailed to relieve a constraint. Of course, if curtailment of multiple transactions is necessary, non-firm service would be curtailed prior to firm service. However, the Commission established that, in emergencies, the transmission provider had the discretion to interrupt firm service under the tariff to ensure the reliability of its transmission system.

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300 *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,749; *mimeo* at p. 335.

In terms of reliability, we believe that sufficient safeguards have been established to protect native load. In particular, the transmission provider is responsible for planning and maintaining sufficient transmission capacity to safely and reliably serve its native load. Order Nos. 888 and 889 permit the transmission provider to reserve, in its calculation of ATC, sufficient capacity to serve native load.

Allegations that a utility did not curtail on a non-discriminatory basis, but instead favored a certain class of customer or type of transaction should be filed in a section 206 complaint proceeding to be reviewed on a case-specific basis. While it is true that such complaints will be processed on an after-the-fact basis, it is only on a fact-specific basis that such complaints can be fully and adequately reviewed.

Additionally, tariff section 14.7 does in fact establish that for curtailment purposes, non-firm point-to-point transmission shall be subordinate to firm transmission service and non-firm service may also be interrupted for economic reasons. However, adopting curtailment schemes based solely on classes of service, as proposed by the VA Com, is inappropriate. Specifically, VA Com's proposal to curtail all non-firm transmission transactions prior to firm transactions could exacerbate an emergency situation. For example, a curtailment could be necessary due to a constraint affecting northbound transactions. However, curtailing all non-firm transactions, including southbound transactions (or counterflows), could worsen the situation. Accordingly, the Commission believes the approach established in the Final Rule of allowing non-discriminatory curtailments of the transaction(s) that effectively relieve(s) the constraint is appropriate.

In response to CCEM's concerns regarding the potential for inconsistent rules for different utilities, pools or control areas, the Commission explained in the Final Rule that any proposed deviations from the non-price terms and conditions

of the pro forma tariff, such as regional practices, must be adequately supported by the utility proposing the change.

Finally, Order No. 888 did not abrogate existing contracts;[301] therefore, customers with unique curtailment priorities established by pre-existing contracts would not have these priorities eliminated for the term of the existing contract.

b. Curtailment and Interruption Provisions for Non-firm Service

In the Final Rule, the Commission explained that it had clarified in the pro forma tariff that a network customer's economy purchases have a higher priority than non-firm point-to-point transmission service (citing AES Power, Inc.[302]).[303]

The Commission also revised the pro forma tariff to allow the transmission provider to curtail non-firm service for reliability reasons or to interrupt the service for economic reasons (i.e., in order to accommodate (1) a request for firm transmission service, (2) a request for non-firm service of greater duration, (3) a request for non-firm transmission service of equal

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duration with a higher price, or (4) transmission service for economy purchases by network customers from non-

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[301] We note that in Order No. 888 we partially modified existing economy energy coordination agreements. *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,666; *mimeo* at p. 91.

[302] 69 FERC ¶61,145, at p. 62,300 (1994) (proposed order), 74 FERC ¶61,220 (1996) (final order).

[303] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,750; *mimeo* at pp. 338-39.

designated resources). The Commission further explained that a firm point-to-point customer's use of transmission service at secondary points of receipt and delivery will continue to have the lowest priority.

Rehearing Requests

For comparability, CCEM asserts that secondary receipt points should be made subordinate to other firm services,[304] but should have priority over non-firm point-to-point transactions. CCEM also argues that non-firm point-to-point service, once scheduled, should not be interrupted to accommodate non-firm service for a network service economy purchase.

VT DPS argues that firm flexible point-to-point service over secondary points of receipt and delivery should have a priority over non-firm point-to-point service (citing sections 14.2 and 14.7 of the pro forma tariff). It argues that this priority is necessary to reflect the fact that point-to-point customers pay for firm service and to be consistent with the treatment of network customers. VT DPS notes that in the natural gas industry the Commission has found that such priority is essential to reflect the fact that firm customers are paying for firm service (citing Order No. 636-B).

APPA asks the Commission to clarify the conditions under which the Commission will allow non-firm service to be interrupted by the transmission provider solely for economic reasons. APPA claims that this clarification is needed so as to prevent interruption of service on a discriminatory basis.

CCEM states that non-firm point-to-point transmission service does not provide the user with a specific capacity

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304 A firm point-to-point customer has a right to change its receipt points if capacity is available. These changed receipt points are known as secondary receipt points. The issue addressed here is the priority that is assigned to those secondary receipt points.

reservation, and therefore such service should bear no reservation or demand-like charges and the customer should pay a commodity-only charge only for when the service is being provided.[305] It contends, for example, that if a customer schedules one week of weekly non-firm transmission service and is interrupted on the second day of service, the customer should only pay for the service it used and should have no responsibility to take or to pay for service for the remainder of the week. Alternatively, it argues that if there are reservation charges and the non-firm customer pays for service on a "take-or-pay basis" regardless of use, non-firm service should not be subject to being bumped once service is scheduled and power is flowing. Moreover, if the non-firm point-to-point transmission customer does pay reservation charges on a "take-or-pay basis," the non-firm reserved capacity should be tradeable in a secondary market.

Commission Conclusion

We reject CCEM's proposal to prevent scheduled non-firm transmission service from being interrupted to accommodate economy purchases for network customers. Non-firm service is provided on an interruptible basis. To the extent CCEM wishes to obtain service that cannot be interrupted to accommodate other transactions, it has the option of requesting firm service in the form of either network or point-to-point transmission service.

APPA's concerns have already been addressed by the Commission. In the Final Rule, the Commission specifically listed the economic reasons that a transmission provider could interrupt non-firm point-to-point transmission to include:

> accommodat[ing] (1) a request for firm transmission service, (2) a request for non-firm service of greater

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305 *See also* Tallahassee.

> duration, (3) a request for non-firm transmission service of equal duration with a higher price, or (4) transmission service for economy purchases by network customers from non-designated resources.[306]

CCEM's arguments are misplaced in that they focus on the specific rate (including any potential credits for service interruption) that utilities may propose for non-firm point-to-point transmission service. Order No. 888 did not mandate any pricing methodology to be used for non-firm point-to-point transmission service.

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Rather, the Commission established the minimum non-price terms and conditions necessary to ensure comparable service. As the Commission explained in the Final Rule, utilities are free to propose any rates for non-firm point-to-point transmission in a section 205 filing consistent with the Commission's Transmission Pricing Policy Statement.[307] However, the Commission will evaluate the appropriateness of such proposed rates against the non-price terms and conditions established in the pro forma tariff or other non-price terms and conditions proposed and fully supported by the utility.[308]

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[306] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,750; *mimeo* at p. 338.

[307] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,769-70; *mimeo* at pp. 395-99.

[308] We note that CCEM has pursued these arguments (raised on rehearing) in utility-specific rate cases and its objections will be addressed there.

The Commission has previously addressed VT DPS' point.[309] Non-firm point-to-point customers pay for non-firm service as their service. Firm point-to-point customers, on the other hand, contract and reserve a specified amount of service over designated points of receipt and delivery. The Commission permitted these firm point-to-point customers to use secondary non-firm service (from points of receipt/delivery other than those designated in their service agreement) on an as-available basis at no additional charge. Because the firm point-to-point customers taking secondary non-firm are accorded this scheduling flexibility at no additional charge, they are properly accorded a lower priority than stand alone, non-firm transmission. In contrast, network customers are responsible for paying for a percentage of total system transmission costs in order to serve their designated network loads whether the energy is from designated network resources or from non-designated resources on an as-available basis.[310] Because the network customer pays a load-ratio share of total transmission costs, it receives a higher priority. Significantly, if any firm point-to-point customer wants to avail itself of the higher priority associated with economy energy purchases under the network tariff, it is free to do so by undertaking the cost responsibilities associated with network service.

Finally, in response to VT DPS, we note that we have chosen different approaches in the electric and natural gas areas. In this regard, we recognize that there is a trade-off between encouraging tradable capacity rights versus maximizing revenues that can be credited against the

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309 *See FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,750; *mimeo* at p. 338, and *AES Power, Inc.*, 69 FERC ¶61,345, at p. 62,300 (1994) (proposed order), 74 FERC ¶61,220 (1996) (final order).

310 This is comparable to the service a utility provides its native load.

transmission provider's costs of providing transmission service. On the electric side, fully developed transmission capacity trading rights simply do not exist at this time, and so we have chosen to emphasize an approach that maximizes revenues to be credited to transmission customers. However, we will continue to evaluate our approach in the context of any future transmission rate proposal that is based on the concept of tradable capacity rights.

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I. Federal and State Jurisdiction: Transmission/Local Distribution

In the Final Rule, the Commission explained that after reviewing the extensive analysis of the FPA, legislative history, and case law contained in both the initial Stranded Cost NOPR and in the Open Access NOPR, and the comments received on that analysis, it reaffirmed its

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assertion of jurisdiction over the transmission component of an unbundled interstate retail wheeling transaction.[451] The Commission also reaffirmed and clarified its determinations regarding the tests to be used to determine what constitute Commission-jurisdictional transmission facilities and what constitute state-jurisdictional local distribution facilities in situations involving unbundled wholesale wheeling and unbundled retail wheeling.

The Commission also explained that where states unbundle retail sales, it will give deference to their determinations as to which facilities are transmission and

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[451] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,780-85; *mimeo* at pp. 427-42.

which are local distribution, provided that the states, in making such determinations, apply the seven criteria discussed in the NOPR and reaffirmed by the Commission. In addition, the Commission clarified that there is an element of local distribution service in any unbundled retail transaction, and further clarified other aspects of its jurisdictional ruling to preserve state jurisdiction over matters that are of local concern and will remain subject to state jurisdiction if retail unbundling occurs.

The Commission reaffirmed its legal determination that if unbundled retail transmission in interstate commerce occurs voluntarily by a public utility or as a result of a state retail access program, this Commission has exclusive jurisdiction over the rates, terms, and conditions of such transmission. The Commission found compelling the fact that section 201 of the FPA, *on its face*, gives the Commission jurisdiction over transmission in interstate commerce (by public utilities) without qualification.

The Commission further explained that when a retail transaction is broken into two or more products that are sold separately, the jurisdictional lines change. In this situation, the Commission emphasized that the state clearly retains jurisdiction over the sale of the power, but the unbundled transmission service involves *only* the provision of "transmission in interstate commerce" which, under the FPA, is exclusively within the jurisdiction of the Commission.

The Commission recognized that in asserting jurisdiction over unbundled retail transmission in interstate commerce by public utilities, it was in no way asserting jurisdiction to order retail transmission directly to an ultimate consumer. It explained that its assertion of jurisdiction is that *if* unbundled retail transmission in interstate commerce by a public utility occurs voluntarily or as a result of a state retail wheeling program, the Commission has exclusive jurisdiction over the rates, terms, and conditions of such transmission and public

utilities offering such transmission must comply with the FPA by filing proposed rate schedules under section 205.

The Commission further clarified that nothing in its jurisdictional determination changes historical state franchise areas or interferes with state laws governing retail marketing areas of electric utilities. It explained that while its jurisdiction cannot affect whether and to whom a retail electric service territory (marketing area) is to be granted by the state, and whether such grant is exclusive or non-exclusive, neither can state jurisdiction affect this Commission's exclusive jurisdiction over transmission in interstate commerce by public utilities.

The Commission also adopted a new section 35.27(b) as follows:

> Nothing in this part (i) shall be construed as preempting or affecting any jurisdiction a state commission or other state authority may have under applicable state and federal law, or (ii) limits the authority of a state commission in accordance with state and federal law to establish (a) competitive procedures for the acquisition of electric energy, including demand-side management, purchased at wholesale, or (b) non-discriminatory fees for the distribution of such electric energy to retail consumers for purposes established in accordance with state law.

With respect to the Commission's adoption of the Open Access NOPR's functional/technical tests for determining what facilities are Commission-jurisdictional facilities used for transmission in interstate commerce and what facilities

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are state-jurisdictional local distribution facilities, the Commission concluded that it could not divine a bright line for unbundled retail transmission by the public utility that

previously provided bundled retail service to the end user. The Commission added that the limited case law, including *Connecticut Light & Power Company v. FPC* (*CL&P*) and *Federal Power Commission v. Southern California Edison Company* (the *Colton* case),[452] supports a case-by-case determination.[453] Accordingly, the Commission stated that its technical test, with its seven indicators, will permit reasoned factual determinations in individual cases.

The Commission made two clarifications regarding local distribution in the context of retail wheeling. First, it explained that even if its technical test for local distribution facilities were to identify no local distribution facilities for a specific transaction, states have authority over the *service* of delivering electric energy to end users. Second, the Commission explained that through their jurisdiction over retail delivery services, states have authority not only to assess retail stranded costs but also to assess charges for so-called stranded benefits, such as low-income assistance and demand-side management.

Thus, under this interpretation of state/federal jurisdiction, the Commission explained, customers have no incentive to structure a purchase so as to avoid using identifiable local distribution facilities in order to bypass state jurisdiction and thus avoid being assessed charges for stranded costs and benefits.

The Commission further determined that it is appropriate to provide deference to state commission recommendations regarding certain transmission/local distribution matters that arise when retail wheeling occurs.

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[452] 324 U.S. 515 (1945) (*CL&P*); 376 U.S. 205 (1964) (*Colton*).

[453] The Commission included a detailed legal analysis in appendix G to Order No. 888. The Commission explained that it was particularly persuaded by the Supreme Court's statement that whether facilities are used in local distribution is a question of fact to be decided by the Commission as an original matter. *See CL&P*, 324 U.S. at 534-35).

In instances of unbundled retail wheeling that occurs as a result of a state retail access program, the Commission indicated that it will defer to recommendations by state regulatory authorities concerning where to draw the jurisdictional line under the Commission's technical test for local distribution facilities, and how to allocate costs for such facilities to be included in rates, provided that such recommendations are consistent with the essential elements of the Final Rule.[454] Moreover, the Commission indicated that it will consider jurisdictional recommendations by states that take into account other technical factors that the state believes are appropriate in light of historical uses of particular facilities.

As a means of facilitating jurisdictional line-drawing, the Commission stated that it will entertain proposals by public utilities, filed under section 205 of the FPA, containing classifications and/or cost allocations for transmission and local distribution facilities. However, the Commission explained that, as a prerequisite to filing transmission/local distribution facility classifications and/or cost allocations with the Commission, utilities must consult with their state regulatory authorities. If the utility's classifications and/or cost allocations are supported by the state regulatory authorities and are consistent with the principles established in the Final Rule, the Commission indicated that it will defer to such classifications and/or cost allocations.

Furthermore, the Commission stated that deference to state commissions with regard to rates, terms, and conditions may be appropriate in some circumstances. The Commission explained that when unbundled retail wheeling in interstate commerce occurs, the transaction has two components for

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[454] In order to give such deference, the Commission noted its expectation that state regulators will specifically evaluate the seven indicators and any other relevant facts and make recommendations consistent with the essential elements of the Rule.

jurisdictional purposes—a transmission component and a local distribution component. It again emphasized that the Commission has jurisdiction over facilities used for the transmission component of the transaction, and the state has jurisdiction over facilities used for the local distribution component. Thus, the Commission stated,

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the rates, terms and conditions of unbundled retail transmission by a public utility must be filed at the Commission. However, the Commission added, if the unbundled retail wheeling occurs as part of a state retail access program, it may be appropriate to have a separate retail transmission tariff[455] to accommodate the design and special needs of such programs. In such situations, the Commission indicated that it will defer to state requests for variations from the FERC wholesale tariff to meet these local concerns, so long as the separate retail tariff is consistent with the Commission's open-access policies and comparability principles reflected in the tariff prescribed by the Final Rule. In addition, the Commission indicated that the rates must be consistent with its Transmission Pricing Policy Statement, and the guidance set forth in Order No. 888 concerning ancillary services.[456]

The Commission also expressed concern, just as it did with buy-sell arrangements in the gas industry, that buy-sell arrangements can be used by parties to obfuscate the true transactions taking place and thereby allow parties to circumvent Commission regulation of transmission in interstate commerce. Thus, the Commission reaffirmed its

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[455] The Commission noted that such a tariff could be different from the tariff that applies to wholesale customers, but that such tariff would still be filed with the Commission under FPA section 205.

[456] In applying the principles of the Final Rule to retail transmission tariffs, the Commission emphasized that it clearly cannot order retail wheeling directly to an ultimate consumer. (citing FPA section 212(h)).

conclusion that it has jurisdiction over the interstate transmission component of transactions in which an end user arranges for the purchase of generation from a third-party. Moreover, the Commission indicated that it will address these transactions on a case-by-case basis.

Rehearing Requests

Oppose Commission Assertion of Jurisdiction Over Unbundled Retail Transmission

Several state commissions indicate that, recognizing that the case law is not dispositive concerning the question of unbundled retail transmission services (either because the cases do not involve the transmission of power to retail customers or "fence off" local distribution from federal regulation), at least one court (*Wisconsin-Michigan Power Company v. FPC*, 197 F.2d 472 (7th Cir. 1952), *cert. denied*, 345 U.S. 934 (1953)) explicitly applied the wholesale/retail distinction to distinguish transmission and local distribution services.[457] Thus, they argue, the Commission should apply the wholesale versus retail analysis to the question of unbundled retail transmission.

IL Com asserts that retail transmission by a public utility directly to an end user has always (even before the FPA was enacted) been subject to regulation by the states. It contends that no change in law has occurred which justifies the Commission's claim of expanded jurisdiction. Moreover, it disagrees with the Commission's conclusion that the unbundled delivery by the previous public utility generation supplier directly to an end user is in interstate commerce. It argues that the FPA was never intended to disturb the jurisdiction of state regulators that existed prior to its passage and that retail transmission of electric energy by a public utility to an end user was under state jurisdiction before the *Attleboro* decision and has remained under state jurisdiction

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457 *E.g.*, NARUC, WI Com, WY Com.

in the over sixty years following *Attleboro*. Even after unbundling, according to IL Com, transmission to a retail customer still involves a retail sale of transmission.

NARUC and VA Com assert that the legislative history provides little support for the Commission's conclusion that the act of unbundling generation from delivery serves to shift jurisdiction from a state commission to the Commission. If anything, they contend, the jurisdictional structure of the FPA is predicated on the distinction between retail and wholesale transactions, not bundled and unbundled services. They assert that the Commission should conclude that the rates, terms and conditions of service for delivery of power by a utility to an end-use customer are subject to the jurisdiction of the state commission regulating the utility, regardless of the identity of the party generating

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or reselling the power or the facilities used to transport the power.

NARUC asserts that the Commission did not address a point raised in NARUC's reply comments as to how the removal of generation serves to unbundle the retail delivery function into separate transmission and distribution services. It maintains that the Commission simply assumes that a resulting transmission transaction is created when power is sold to a retail consumer by someone other than the utility delivering the power.[458]

MI & NH Coms ask the Commission to vacate those portions of the Rule that find that the Commission has jurisdiction over the transmission component of an

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458 *See also* IA Com (use of a utility's transmission system to serve its own retail customers is a bundled part of the retail sale transaction, which supports a simpler jurisdictional test holding that a movement of power by the last utility in any chain of delivery to a retail customer is a distribution transaction).

unbundled retail sale in a local retail wheeling transaction. They assert that the Commission should confine its activity to wholesale transactions or those interstate transactions that do not implicate matters of local concern. They argue that the dual federal/state regulatory scheme establishes that Congress' intent is that state regulation of retail wheeling is *not* preempted by federal law as established in FPA section 201. They oppose unnecessary federal intrusion into local matters under a one-size-fits-all approach and assert that the retail wheeling initiatives in New Hampshire and Michigan are tailored to the unique utility environment in each state.

Central Illinois Light argues that unbundling of retail electric service does not change the states' longstanding jurisdiction over retail electric service and local distribution, even when that service involves the use of transmission in interstate commerce. It asserts that 201(b)(1) ("transmission of electric energy in interstate commerce") cannot be read in a vacuum.

MN DPS & MN Com and OH Com assert that the Commission should have no role in the regulation of retail services, be they bundled or unbundled. They argue that, in refusing to grant the Commission authority over retail wheeling, Congress left jurisdiction over retail electric service to the states. They conclude that the Final Rule contains insufficient legal and/or policy justification for the Commission's assertion of jurisdiction over unbundled retail transmission services.

MN DPS & MN Com assert: "FERC bases its usurpation of state authority over retail transmission rates on its claim that balkanization would occur without the assertion of FERC authority. Therefore, the parties are entitled to rehearing so that this essential issue can be further analyzed." (MN DPS & MN Com at pp. 1-3).

FL Com argues that the Commission has not justified why the act of unbundling prices expands the Commission's

jurisdiction into retail marketing areas. It argues that Section 212(g) of the FPA has the effect of prohibiting the Commission from usurping existing state jurisdiction over retail transmission service, whether bundled or unbundled. According to FL Com, FERC's jurisdiction over transmission terminates at the territorial boundary of each electric utility in Florida. It supports wheeling in jurisdiction for state commissions and wheeling out and wheeling through jurisdiction for the Commission.

IN Com opposes federalization of retail wheeling transactions within a state's boundaries as contrary to the FPA's legislative history and case law.

NJ BPU asserts that by claiming jurisdiction over unbundled retail transmission, the Commission is creating a disincentive for states to implement retail access because, by ordering retail access, the states may be relinquishing their jurisdiction over unbundled retail transmission terms and conditions—jurisdiction that they would maintain under a bundled scenario.[459] PA Com argues that the Commission does not have the authority to order retail wheeling and that the jurisdictional formula is challengeable on engineering and legal grounds. It concludes that the Commission does not have jurisdiction over unbundled interstate retail transmission service. PA Com notes that the 1996 House and Senate hearings have

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raised the question whether the Commission has the statutory authority to restructure the electric industry. PA Com questions the Commission's definition of the "traditional tasks of state and federal regulators" on the basis of section 201(b) of the FPA, the Supremacy Clause, and the Tenth Amendment of the U.S. Constitution.

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[459] *See also* PA Com.

Support Broader Assertion of Jurisdiction by the Commission Over Retail Wheeling

NY Utilities declare that the Commission has jurisdiction over retail wheeling from the source to the load, but does not have jurisdiction over transmission in bundled retail service. They assert that the Commission's reliance on state jurisdictional local distribution as a predicate to abstain from allowing retail wheeling stranded cost recovery is without foundation. They further assert that a unique element that sets local distribution apart from transmission is not the size of the facility or the length of travel, but that transportation is bundled with a retail sale. According to NY Utilities, the plain meaning of the FPA shows that local distribution is bundled retail service. They claim that the legislative history, to the extent necessary, and court cases support FERC jurisdiction over all aspects of retail wheeling, but makes clear that the Commission cannot regulate bundled retail service. They add that the NGA also demonstrates that local distribution means bundled retail service.

Commission Conclusion

In concluding that this Commission has exclusive jurisdiction over the rates, terms and conditions of unbundled retail transmission by public utilities in interstate commerce, the Commission in Order No. 888 thoroughly examined the statutory language of the FPA and its legislative history, and relevant FPA and NGA case law. While the state commissions on rehearing would like us to draw a bright line that gives them, to varying degrees, jurisdiction over retail interstate transmission by public utilities, no party on rehearing has raised any legislative history or case law that was not previously considered and that would support the proposition that states have jurisdiction over any unbundled transmission in interstate commerce. As explained below, we reaffirm our jurisdictional interpretation on rehearing and

believe that it is supported by the recent decision in *United Distribution Companies v. FERC.* [460]

Many of the rehearing arguments focus on the fact that states historically (even prior to the FPA) regulated retail transmission insofar as it was a component of bundled electric service to an end user, and they argue that by asserting jurisdiction over unbundled retail transmission, the Commission is somehow "taking away" jurisdiction the states previously had. The flaw in these arguments is their inherent assumption that jurisdiction over transmission service turns upon the question of whether the transmission service is being provided for "wholesale" or "retail" power sales. That is not the case. The question of jurisdiction rather turns upon the extent of the Commission's exclusive jurisdiction over transmission in interstate commerce under the FPA. The fact that states historically regulated most retail transmission service as a part of a bundled retail power sale is not the result of a legal requirement; it is the practical result of the way electricity has historically been bought and sold. However, the shape of power sales transactions is rapidly changing. Rather than claiming "new" jurisdiction, the Commission is applying the same statutory framework to a business environment in which, as discussed below, retail sales and transmission service are provided in separate transactions.

In the past, retails ales occurred almost exclusively on a bundled basis (i.e., the same entity provided a delivered product called electric energy and transmission was part and parcel of that product). The FPA clearly reserves the right to regulate retail sales of electric energy to the states. As we explained in the Final Rule, however, in today's markets, and increasingly in the future as more states adopt retail wheeling programs, retail transactions are being broken into products that are being sold separately: transmission and generation.

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460 88 F.3d 1105, 1152-53 (1996) (*United Distribution Companies*).

Moreover, these products are being sold increasingly by two or more different entities. For example, a transaction may

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involve transmission service from one or more transmission providers who move power from a distant generation supplier, over the interstate transmission grid, to an end user. Because these types of products and transactions were not prevalent in the past, the jurisdictional issue before us did not arise and, contrary to IL Com's argument, the Commission cannot be viewed as "disturbing" the jurisdiction of state regulators prior to and after the *Attleboro* case.[461]

As we also explained in the Final Rule, the legislative history of the FPA and the relevant case law similarly reflect the historical market structure in which electricity and transmission generally were bought on a bundled basis.[462] Today's unbundled world simply was not contemplated and the cases do not resolve dispositively this jurisdictional issue. The case law focuses primarily on the bright line between wholesale sales and retail sales of *energy*, and transmission in interstate as opposed to intrastate commerce. It does not address unbundled retail interstate transmission.[463] We

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461 *Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927).

462 The case law is addressed extensively in appendix G to the Final Rule and will not be repeated here.

463 On rehearing, several parties argue that at least one court case, *Wisconsin-Michigan Power Co. v. FPC*, 197 F.2d 472 (7th Cir. 1952), *cert. denied*, 345 U.S. 934 (1953) explicitly applied the wholesale/retail distinction to distinguish transmission and local distribution services. The Commission discussed this case in detail in appendix G to the Final Rule, *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,974-75; *mimeo* at pp. 22-25. As we stated there, the court's interpretation of the legislative history of the FPA was at odds with both the plain words of the statute as well as the language of the House Report on the FPA (H.R. Rep. No. 1318 at p. 27). It also did not mention the Senate Report on the FPA, which clearly recognized

therefore have interpreted the case law in light of changed circumstances and have relied in the first instance on the plain wording of the statute. We find compelling that section 201 of the FPA, on its face, gives the Commission jurisdiction over transmission in interstate commerce without qualification; unlike our jurisdiction over sales of electric energy, which section 201 specifically limits to sales at wholesale, the statute does not limit our transmission jurisdiction over public utilities to wholesale transmission.

Since the time Order No. 888 issued, the D.C. Circuit has addressed a similar issue in interpreting section 1(b) of the NGA, the provision that parallels section 201(b) of the FPA. Under section 1(b), the Commission's jurisdiction does not apply "to the local distribution of natural gas or to the facilities used for such distribution." Similarly, under section 201(b) of the FPA, the Commission shall not have jurisdiction, except as specifically provided, "over facilities used for the generation of electric energy or over facilities used in local distribution. . . ." In responding to arguments regarding the scope of state authority over "local distribution" of natural gas, the court distinguished between bundled and unbundled sales:

> States have been—and are still—permitted to regulate LDCs' bundled sales of natural gas to end-users because those transactions include transportation over local mains and the retail sales of gas. In contrast, states have *never* regulated the terms and conditions of interstate pipeline transportation. When the gas sales element is severed—i.e., unbundled—from the transactions, FERC retains jurisdiction over the *interstate*

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jurisdiction over all interstate transmission lines, whether or not a sale of energy is carried by those lines (S. Rep. No. 621 at p. 48). We therefore reject arguments that this single case is in any way dispositive of the issue before us.

> *transportation* component." [*United Distribution Companies*, 88 F.3d at 1153 (footnote omitted) (emphasis in original).]

The court's reasoning is also applicable to and supports our jurisdictional determination in Order No. 888.

Several state commissions point to section 212(h) of the FPA and argue that Congress, in refusing to grant the Commission authority to order retail wheeling, left all jurisdiction over retail transmission to the states. We disagree. What Congress did in section 212(h) was to prohibit us from *ordering* transmission directly to an ultimate consumer. We readily recognize and respect this prohibition. However, the ability to order retail

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wheeling is a separate issue from whether we have jurisdiction over the rates, terms and conditions of retail wheeling in interstate commerce that is ordered by a state or that is provided voluntarily. Congress, in enacting section 212(h), did nothing to modify our jurisdiction under sections 201, 205 and 206 over the rates, terms and conditions of interstate transmission by public utilities.

Similarly, we reject FL Com's arguments that section 212(g) of the FPA prohibits the Commission from asserting any jurisdiction over unbundled retail transmission. Section 212(g) prohibits the Commission from issuing an order that is inconsistent with any state law that governs retail marketing areas of electric utilities. As we stated in the Final Rule, while our jurisdiction cannot affect whether and to whom a retail electric service territory (marketing area) is to be granted by the state, and whether such grant is exclusive or non-exclusive, neither can state jurisdiction affect this Commission's exclusive jurisdiction over the rates, terms and conditions of transmission in interstate commerce by public utilities. We also reject arguments by the FL Com that this Commission's jurisdiction over transmission terminates at

the territorial boundary of each electric utility in Florida. This argument is flatly contrary to the longstanding interpretation of the FPA by the United States Supreme Court.[464464]

Commission's Seven Factor Test

IL Com argues that the Commission should withdraw its technical test. It contends that retail wheeling jurisdiction should follow function and that the function served by public utility facilities in providing retail service does not change upon the unbundling of service to retail customers. According to IL Com, Commission jurisdiction would extend to the service of delivering electric energy by a public utility to wholesale customers, regardless of the nature and extent of the public utility's facilities used to make that delivery. Similarly, it asserts, state jurisdiction would extend to the service of delivering electric energy by a public utility directly to retail customers, regardless of the nature and extent of the public utility's facilities used to make that delivery.

NARUC argues that the seven-factor test does not result in the bright line discussed in *FPC v. Southern California Edison Company*, 376 U.S. 205 (1964). The facility-by-facility categorization of utility systems on a company-specific basis, it asserts, is hardly consistent with the Court's decision to make case-by-case analysis unnecessary.

OH Com asserts that the seven factors provide no useful insight into the nature of local distribution service. It adds that reliance upon technical tests to determine local distribution lacks legal foundation. It further contends that the jurisdictional bright line established by Congress focuses upon the nature of the transaction, not the functional or

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464 *See FPC v. Southern California Edison Co.*, 376 U.S. 205 (1964) (*Colton* case). IN Com makes a similar argument and opposes "federalization" of retail wheeling within a state's boundaries. We reject this argument on the same basis.

technical characteristics of a particular wire, in determining whose jurisdictional authority attaches to a particular transaction and facilities. It concludes that the Commission should adopt the Ohio-proposed retail marketing area "wheeling in" jurisdictional approach.

PA Com contends that the Commission's seven indicia are not acceptable measures of local distribution and challenges each factor.

NH & MI Coms declare that the criteria for distinguishing transmission facilities from local distribution facilities should not be limited to the seven given in the Rule, but should allow consideration of any other relevant criteria for separating local concerns from matters legitimately federal in nature.

NJ BPU argues that the engineering-driven definition does not resolve many of the hazy areas. To the extent that the seven factors do not reflect or cannot be reconciled with the particular circumstances, it contends that the states may be hamstrung in their ability to make

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reasoned decisions that comport with Order No. 888.[465]

Similarly, NY Com argues that five of the seven factors (1, 2, 4, 6,and 7) are not accurate when applied to large metropolitan areas and remote rural areas. It asserts that local distribution facilities are not necessarily close to retail customers and the assumption that local distribution facilities are primarily radial in character fails to account for network systems. It adds that reconsignment or transportation of power to different markets can and does occur at the local

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[465] *See also* WI Com (criteria do not appropriately reflect the mixed nature of many facilities in systems that are closely integrated and the application of the criteria to the electric system in Wisconsin would supplant state jurisdiction over a large number of facilities whose primary functions are local reliability and retail service).

distribution level. It further adds that the presence of meters is not a discerning characteristic of where interstate transmission ends and local distribution begins; meters are frequently not part of the transmission/local distribution interface. Nor, according to NY Com, are local distribution systems necessarily of reduced voltage. Instead of the 7 criteria, NY Com argues that the Commission should adopt a functional measure of local distribution based on factors 3 and 5 (interstate transmission ends and local distribution begins where electricity flows into a comparatively restricted geographic area and does not flow back out of that area and the power is consumed in that area) and on the traditional classification of the facilities by the state regulatory body (or what the utility has traditionally classified as local distribution).

Commission Conclusion

Several parties on rehearing do not like the seven-factor technical test for local distribution facilities that was set forth in Order No. 888. That test takes into account both technical and functional characteristics of the transaction involved. The parties on rehearing propose instead a variety of bright line tests. For example, IL Com wants state jurisdiction to extend to the "service" of delivering electric energy to retail customers, which it would define to give it jurisdiction regardless of the nature and extent of the facilities used to make the delivery. OH Com proposes that the Commission adopt a retail marketing area "wheeling in" jurisdictional approach which would give it jurisdiction over facilities within territorial boundaries.

In response, we do not interpret the FPA to permit us in effect to rewrite the statute to give states jurisdiction over interstate transmission services. Moreover, we reject arguments of OH Com that our seven-factor test lacks legal foundation, and arguments of NARUC that we are somehow bound to develop a bright line test. While Congress established a jurisdictional bright line between wholesale and

retail sales of energy, there is no such bright line that we can divine with regard to transmission and local distribution facilities. The Supreme Court, in both *Colton* and *CL&P*,[466] has instructed us that whether facilities are used in local distribution is a question of fact to be decided by the Commission as an original matter. The seven factors will permit us to undertake this fact-specific determination.

We acknowledge the concerns raised by several state commissions that the seven-factor test does not, as NJ BPU puts it, resolve many of the hazy areas, and that there may be other factors that should be taken into account in particular situations. The seven-factor test is intended to provide sufficient flexibility to take into account unique local characteristics and historical usage of facilities used to serve retail customers. We specifically stated in the Final Rule that we will consider jurisdictional recommendations by states that take into account other technical factors that states believe are appropriate in light of historical uses of particular facilities. Moreover, we will defer to facility classifications and/or cost allocations that are supported by state regulatory authorities. For example, in the ongoing California electric utility restructuring proceeding, the Commission deferred to the State PUC's recommendations regarding the split between state jurisdictional local distribution facilities and Commission-jurisdictional

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transmission facilities.[467]

Oppose transmission of public utility purchases for sale at retail

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[466] *See Colton*, 376 U.S. at 210 n.6; *CL&P*, 324 U.S. at 531-36.

[467] *Pacific Gas and Electric Company, et al.*, 77 FERC ¶61,325, at p. 61,325 (1996).

IL Com objects to the transmission unbundling requirement if it is intended to require public utilities to take transmission services under their own FERC tariffs for purchases of power intended for distribution by the public utility to retail customers. According to IL Com, a distinction must be made between the public utility's use of its transmission system in cases in which the public utility purchases wholesale power for sale for resale, and cases in which the public utility purchases wholesale power to serve native load retail customers. It argues that the Commission cannot legally regulate, or place conditions on, the manner in which a utility uses its transmission system to make sales of electric energy at retail. It contends that the Commission must exempt public utility power purchases for sale at retail from the unbundling requirement. It recommends that the Commission insert the words "for sale for resale" after the word "purchases" in section 35.28(c)(2) and after the word "purchase" in section 35.28(c)(2)(i).

Commission Conclusion

The Commission rejects arguments of IL Com that if unbundled retail wheeling occurs either voluntarily or as a result of a state retail program, we cannot require the utility to take service under its own transmission tariff for sales to retail customers. This requirement is a term and condition of unbundled retail interstate transmission service and, as explained above, therefore is within our exclusive jurisdiction. Additionally, this should not in any way infringe on state retail programs or service to retail customers. Rather, it ensures that non-discriminatory transmission services are provided to all potential retail power competitors.

Further, as stated previously in section IV.C.1.b (Transmission Providers Taking Service Under Their Tariff), we clarify that a transmission provider does not have to "take service" under its own tariff for the transmission of power that is purchased on behalf of bundled retail customers.

Oppose buy-sell transaction analysis

PA Com asserts that there is a potential for jurisdictional conflict with respect to buy-sell transactions that is a direct consequence of the technical-functional test (which PA Com challenges).

IL Com argues that states have exclusive authority to regulate buy-sell arrangements as bundled retail sales. It further argues that the Commission cannot make a bundled retail sale into an unbundled retail sale simply by characterizing it as the functional equivalent of an unbundled retail sale; by re-characterizing them the Commission is effectively ordering the unbundling of buy-sell arrangements. It asserts that buy-sell arrangements on the electric side are not an end run around clear federal jurisdiction and that the Commission should withdraw its assertion of jurisdiction over the retail transmission component of unbundled retail sales.

VT DPS contends that the Commission's rationale is flawed: "FERC's analysis rests on the same very shaky ground as its similar claim of jurisdiction over buy-sell arrangements by local gas distribution companies." According to VT DPS, all retail transactions are subject to state jurisdiction and asks the Commission to clarify that the Commission defines buy-sell as it did in the NOPR, but also acknowledge that it has no jurisdiction over such arrangements.

IN Com asserts that in the absence of any record of abusive and undermining actions by states under the guise of buy-sell arrangements, there is not even a remedial justification to touch buy-sell transactions. It contends that a difference between the FPA and the NGA warrants different treatment—the FPA exempts from FERC jurisdiction local distribution and transmission of electric energy in intrastate commerce. By redefining interstate transmission, IN Com claims that the Commission proposes to do away with the

meaning history has accorded to a variety of transactions previously considered wholly intrastate in nature. According to IN Com, states should be allowed

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to experiment with and allow different forms of buy-sell transactions as part of the evolving marketplace.

Commission Conclusion

Four parties (PA Com, IL Com, VT DPS and IN Com) have raised concerns regarding the Commission's determination that it has jurisdiction over the interstate transmission component of transactions in which an end user arranges for the purchase of generation from a third party. The Commission reiterates that we will have to address these situations on a case-by-case basis. We disagree with IL Com that States have exclusive authority to regulate the interstate transmission component of buy-sell transactions. Similarly, we deny the VT DPS request that we acknowledge no jurisdiction over such arrangements. The fact remains that these arrangements *could* be used by parties to obfuscate the true transactions taking place and thereby allow parties to circumvent Commission regulation of transmission in interstate commerce. We reserve our authorities to ensure that public utilities and their customers are not able to circumvent non-discriminatory transmission in interstate commerce. In response to VT DPS' contention that the Commission's analysis here rests on the same shaky ground as its similar claim of jurisdiction over buy-sell arrangements by local gas distribution companies, we note that the D.C. Circuit recently affirmed the Commission's assertion of jurisdiction over buy/sell arrangements under the Natural Gas Act.[468]

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468 *United Distribution Companies*, 88 F.3d at 1154-57.

State jurisdiction over the service of delivering electric energy to end users

Rehearing Requests

IL Com states that it is far from clear what FERC contemplates by the "service" of delivery of electric energy by a delivering utility in the retail wheeling transaction. It is equally unclear to IL Com whether the "service" to which Order No. 888 refers is a public utility activity over which state regulators would have jurisdiction. IL Com argues that it is the Illinois legislature, not FERC, that determines whether IL Com can regulate something called "delivery service."[469]

MO/KS Coms ask the Commission to clarify the meaning of the statement that even when the test for local distribution facilities identifies no local distribution facilities, the Commission believes that states have authority over the service of delivering electric energy to end users. According to MO/KS Coms:

> The authority to shop at retail and to sell at retail do not exist in the FPA. If the Commission's goal is to recognize the States' authority to establish conditions on retail competition, it need only acknowledge the State jurisdiction to establish the opportunity to shop and sell at retail. If this is what the Commission is seeking to accomplish by its discussion of 'delivery service,' then we support the Commission." [470]

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469 *See also* AK Com (should not create a fictional concept of delivery service—the legal reality is that, under retail competition, state law will establish a customer's right to be served and a generation owner's right to produce power. AK Com asserts that the state can then attach conditions to those rights).

[470] MO/KS Coms at pp. 1-13.

Coalition for Economic Competition asserts that the Commission failed to consider that the sale of electric energy may take place outside of the state into which the energy is transmitted, and that the local regulatory commission may have no jurisdiction over either the sale or the transmission of the energy.

Commission Conclusion

Several parties ask us to clarify our conclusion that even when the seven-factor test for local distribution facilities does not identify local distribution facilities, we believe states have authority over the "service" of delivering electric energy to end users. We clarify that states have the authority to determine the retail marketing areas of electric utilities within their jurisdictions, and the end user services that those utilities must provide, but we did not in Order No. 888 intend to opine on the extent of authority given by state legislatures to their state commissions. Rather, our statement regarding state authority over the "service" of delivering electric energy is intended to recognize the historical and local nature of delivering power to end users and the

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states' legitimate concerns and responsibilities in regulating local matters.

Deference to states

Rehearing Requests

Support broader deference

NARUC and IL Com argue that the Commission should not simply defer to state recommendations concerning the application of the seven-factor test or the recovery of stranded costs, but should conclusively rely on the findings by state commissions.

NY Com argues that the Commission should not limit deference to instances in which states order retail wheeling,

but should defer to all state commission recommendations regarding the definition of local distribution facilities.

FL Com asserts that the Rule fails to say where deference will be given. It argues that the Rule should state that when a state commission has held a proceeding on matters related to the requirements of the Rule, the Commission shall give deference to the state commission decisions. Moreover, it asserts that the Commission should codify the deference standard: "When a state commission has held a proceeding on matters related to the requirements of this rule, the Commission shall give deference to the state commission decisions." (FL Com at pp. 7-9).

The commitment to defer to a state regulatory commission or agency, argues NE Public Power District, should be clarified with respect to utilities located in Nebraska, which has no such commission or agency. NE Public Power District assumes that deference will be accorded to decisions of NE Public Power District's Board of Directors; if not, it asks the Commission to clarify.

PA Com asks the Commission to clarify what a state regulatory agency must demonstrate to secure deference and to define the term "consult." PA Com states that, in discussing the seven indicia, the Commission states that it will "consider" jurisdictional recommendations by states, which PA Com asserts is much different from deference. It also asserts that the Commission must clarify what it will do if a utility's classifications and/or cost allocations are not supported by state regulatory authorities.

Oppose deference to state authorities

TANC argues that the Commission erred in deferring to state regulatory authorities in drawing jurisdictional lines for local distribution facility classifications and/or cost allocations. According to TANC, the Commission unlawfully and unnecessarily abdicated its jurisdiction under the FPA (citing *New England Power Co. v. New Hampshire*, 455 U.S.

331, and *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953). With respect to ISOs, it asserts that the Commission should not defer to state authority in making determinations with respect to classifications of facilities.

Commission Conclusion

In response to NARUC and IL Com's arguments that this Commission should not simply defer to state commissions regarding application of the seven-factor test but instead should conclusively rely on the findings of state commissions, we believe this is inconsistent with the case law which states that local distribution it is a matter of fact for the Commission to determine as an original matter.[471] Additionally, we have an independent obligation to ensure that we are fulfilling our responsibilities under the FPA to regulate facilities that are used in interstate commerce. We cannot delegate our jurisdiction. However, we intend to provide broad deference to states in determining what facilities are Commission-jurisdictional transmission facilities and what facilities are state-jurisdictional local distribution facilities, so long as our comparability principles are not compromised and we are able to fulfill our responsibilities under the statute.

We reject FL Com's suggestion that we codify the deference standard. This is neither necessary nor appropriate. In response to NE Public Power District's request that we clarify to whom we would give deference in Nebraska, we clarify that because Nebraska does not have an electric regulatory commission or agency, there is no appropriate regulatory entity to whom our deference standard would apply; accordingly, we will address the

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471 *See Colton* and *Connecticut Light and Power, supra.*

transmission/local distribution issue for Nebraska without giving deference to any particular entity. In response to PA Com's request that we clarify what we will do if a utility's classifications and/or cost allocation proposals are not supported by state regulatory authorities, we will make a determination based on the factual record before us in a particular case, taking into account the views of the state regulatory authority.

TANC has argued that we have unlawfully abdicated our jurisdiction by deferring to state recommendations. TANC confuses delegation of jurisdiction, which we cannot do, with willingness to defer to states based on their application of criteria that we have provided. Even in the cases in which the Commission defers to states' views, we will still independently evaluate all material issues and proceed only where substantial evidence supports the states' views. The Commission clearly can entertain requests for deference in these circumstances.

J. Stranded Costs

As indicated in our prior discussion in Section IV.A.5, there are two major overlapping transition issues that arise as a result of this rulemaking: stranded cost recovery and how to deal with contracts entered into under the prior regulatory regime. We here address stranded cost recovery and, as in the prior discussion, we believe it is important to explain the general context in which our stranded cost determinations have been made before addressing the various rehearing requests on this issue.

In Order No. 888, the Commission removed the single largest barrier to the development of competitive wholesale power markets by requiring non-discriminatory open-access transmission as a remedy for undue discrimination. This action carries with it the regulatory public interest responsibility to address the difficult transition issues that arise in moving from a monopoly, cost-based electric utility

industry to an industry that is driven by competition among wholesale power suppliers and increasing reliance on market-based generation rates. The most critical transition issue that arises as a result of the Commission's actions in this rulemaking is how to deal with the uneconomic sunk costs that utilities prudently incurred under an industry regime that rested on a regulatory framework and a set of expectations that are being fundamentally altered.

The Commission determined in Order No. 888 that it must address stranded costs, and that it must do so at an early stage—particularly in light of the lessons learned from our experience with similar issues in the natural gas area. We noted that when we did a similar restructuring in the gas industry, the D.C. Circuit invalidated the Commission's efforts precisely because the Commission had failed to deal with the stranded cost problem in a satisfactory manner.[472] We explained that, based on the lesson of *AGD*, the Commission cannot change the rules of the game without providing a mechanism for recovery of the costs caused by such regulatory-mandated change.

Since the time Order No. 888 issued, we have been provided with additional guidance from the court in the natural gas area, which has further helped to inform our decisions here. In its decision on review of Order No. 636,[473] the D.C. Circuit upheld the Commission's decision to allow the recovery of gas supply realignment costs. In so doing, the court, while questioning a specific feature of the stranded cost recovery mechanism employed in Order No. 636, has nevertheless again reaffirmed the basic principle that stranded cost recovery is an appropriate component of a regulatory policy aimed at accomplishing a fair and

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[472] *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988) (*AGD*).

[473] *United Distribution Companies v. FERC*, 88 F.3d 1105 (1996) (*United Distribution Companies*).

reasonable transition to competitive markets. The question as to the Commission's ability to allow the recovery of stranded costs has been laid to rest.

The task before the Commission in this rulemaking is thus to determine how best to meet its responsibility to address the costs of the transition to a competitive industry, particularly insofar as those costs are stranded, or in effect rendered unrecoverable, as a result of the transmission access required by us under the

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FPA.[474] As the rehearing arguments demonstrate, there is no consensus on how the Commission should address the stranded cost issue. In fact, petitioners are at polar extremes as to what the Commission should do regarding stranded costs. Some argue that the Commission has gone too far in permitting utilities to seek recovery of stranded costs, whether such costs are associated with wholesale requirements contracts, with retail-turned-wholesale customers, or with retail customers that obtain retail wheeling.[475] Others argue that the Commission has not gone far enough and that it must broaden the scope of stranded

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[474] Such access may be the open access required under this rule or case-by-case transmission access ordered pursuant to FPA section 211.

[475] We note that the regulations implementing this rule use "wholesale stranded cost" and "retail stranded cost" as shorthand terms to refer to the different situations in which a utility may experience stranded costs. However, as the definitions of those terms make clear, it is *not* the nature of the *costs* (wholesale vs. retail) that is controlling for purposes of stranded cost recovery under this Rule. Rather, the controlling factors are the status of the *customer* (wholesale transmission services customer vs. retail transmission services customer) with whom the costs are associated, and whether the transmission tariffs used by the customer to escape its former power supplier (thus causing the stranding of costs to occur) were required by this Commission or by a state commission. As a result, "retail stranded costs" refers to stranded costs associated with retail wheeling customers.

cost recovery permitted under the Rule. Indeed, some would have us be the guarantor for recovery of all uneconomic costs that might be stranded in the move to more competitive markets, no matter how tenuous the nexus to this Rule, and irrespective of state-Federal jurisdictional complexities. Some support the Commission's decision to recover stranded costs directly from the departing customers. Others would prefer that the Commission require utilities to absorb a portion of their stranded costs or that the Commission spread the burden of stranded costs among all of the utility's customers. Some object that the Commission's approach to stranded costs in the electric industry is different from that adopted in the gas industry. Some entities support the Commission's revenues lost approach for measuring a departing customer's stranded cost obligation. Others propose different methods for computing stranded costs.

Given the plethora of positions that entities have raised both initially and on rehearing concerning stranded costs, the Commission has taken a careful, measured approach with regard to stranded cost recovery. The Commission has balanced a number of important interests in order to achieve what it believes will be a fair and orderly transition to competitive markets. These interests include the financial stability of the electric utility industry, upholding the regulatory bargain under which utilities made major capital investments, and not shifting costs to customers that had no responsibility for causing those costs to be incurred. The Commission also has adopted an approach that, for purposes of stranded cost recovery from wholesale transmission customers, relies on the nexus between stranded costs and the use of transmission tariffs required by this Commission and, for purposes of stranded cost recovery from retail customers, recognizes state commission jurisdiction but fills potential regulatory gaps that could arise in the transition to new market structures.

The balancing of interests and considerations described above is reflected in the following central components of the Rule's stranded cost provisions, which are reaffirmed herein.[476] First, the Commission has determined that the most reasonable, legally supportable approach is one that permits utilities to seek recovery of wholesale stranded costs under this Rule (whether the stranded costs are associated with a departing wholesale requirements customer or with a retail-turned-wholesale customer) only in those cases in which there is a *direct nexus* between the availability and use of Commission-required transmission access[477] and the

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stranding of costs. In order for the utility to be eligible to seek recovery of stranded costs from a departing customer, the customer must have obtained access to a new generation supplier through the use of the former supplying utility's Commission-required transmission tariff (i.e., its open-access tariff or a tariff ordered pursuant to FPA section 211), not through the use of another utility's transmission system.

Other cost recovery issues are more appropriately addressed outside the context of this Rule. For example, the Rule is *not* intended to apply to costs associated with the normal risks of competition, such as self-generation, cogeneration, or loss of load, that do not arise from the new, accelerated availability of Commission-required transmission access. If a customer leaves its utility supplier by exercising

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476 We reaffirm below our basic determinations, but make certain clarifications on limited issues and grant rehearing on the municipal annexation issue.

477 As we explain below, by "Commission-required transmission access" we mean the open-access transmission required under this rule or required pursuant to a section 211 order, as well as transmission provided prior to Order No. 888 (and not pursuant to a section 211 order) where such transmission was provided on a case-by-case basis to comply with the Commission's comparability requirement. See note 484 *infra*.

options that could have been undertaken prior to mandatory transmission under Order No. 888 or the Energy Policy Act, or that do not rely on access to the former seller's transmission, there is no direct nexus to Commission-required transmission access and thus no opportunity for stranded cost recovery under the Rule.

Second, the Commission has limited the opportunity to seek stranded cost recovery under the Rule primarily to two discrete situations: (1) costs associated with customers under wholesale requirements contracts executed on or before July 11, 1994 (referred to in the Rule as "existing wholesale requirements contracts") that do not contain an exit fee or other explicit stranded cost provision; and (2) costs associated with retail-turned-wholesale customers. With regard to the existing wholesale requirements contracts, the Commission also has made a finding that it is in the public interest to permit amendments to add stranded cost provisions to these contracts, even if they contain *Mobile-Sierra* clauses, if case-by-case evidentiary burdens are met. We do not interpret the *Mobile-Sierra* public interest standard as practically insurmountable in extraordinary situations such as this one where historic statutory and regulatory changes have converged to fundamentally change the obligations of utilities and the markets in which they and their customers will operate.

Third, Order No. 888 *does not guarantee* that a utility will be allowed to recover stranded costs. Rather, it provides an *opportunity* for such recovery. To be eligible to recover stranded costs from a departing customer in a particular case, the utility must demonstrate that it incurred costs to provide service to the customer based on a reasonable expectation of continuing service to that customer beyond the contract term.[478] In the case of stranded costs associated with

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[478] We have made a minor revision to the regulatory text, section 35.26(c)(2), to conform the language of that section with sections

wholesale requirements contracts customers, if the contract contains a notice of termination provision, that provision is strong evidence that the parties were aware that at some point in the future the customer might seek to find another supplier. Therefore, there is a rebuttable presumption of no reasonable expectation, and therefore no opportunity for stranded cost recovery unless the utility can overcome the presumption.

The Commission has concluded that direct assignment of stranded costs to the departing customer (through either an exit fee or a surcharge on transmission) is the appropriate method for recovery of stranded costs under the Rule. In reaching this conclusion, the Commission carefully weighed the arguments supporting direct assignment of stranded costs against those supporting a more broad-based approach, such as spreading stranded costs to all transmission users of a utility's system, and also took into account the fact that we applied a different approach in the natural gas area. The central considerations that support a direct assignment approach in the electric industry are that the approach follows the traditional regulatory concept of cost causation, it avoids shifting costs to customers that had no responsibility for causing them to be incurred or for causing them to be stranded, and it is still possible to apply such an approach at this stage of the industry's evolution.

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There is no question that, without the stranded cost recovery mechanism, some customers would be far more likely to switch to lower-cost suppliers and enjoy sooner the benefits of a competitive power market. But, as detailed in Order No. 888, such an approach may result in higher costs for other customers. We thus have had to balance the potential for earlier benefits for some customers against other

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35.26(b)(1) and (5). A conforming revision has been made to section 35.26(d)(2)(i).

public interest considerations, most particularly the need to provide a fair mechanism by which utilities can recover the costs of past investments under traditional regulatory concepts of prudently incurred costs and cost causation. The result is not to deny competitive advantages, but only to delay their full realization for some customers so that all customers ultimately will benefit.

While Order No. 888's cost causation approach is different from the Order No. 636 cost spreading approach that was affirmed in the *United Distribution Companies* case, we believe it is the preferable approach given the early stage of the electric utility's competitive transition. We do not read the court's opinion as precluding the Commission from adopting a direct assignment approach in Order No. 888, particularly where, as here, the Commission has fully explained and justified the reasons for following traditional cost causation principles. In addition, although the *United Distribution Companies* court remanded for further consideration (in light of Order No. 636's cost spreading approach) the decision not to require any pipeline absorption of gas supply realignment costs, the Commission has fully explained how its decision in Order No. 888 not to require any utility absorption of stranded costs is consistent with its decision to follow traditional cost causation principles. With respect to the fundamental conclusion that utilities should be permitted an opportunity to recover their prudently incurred costs, Order No. 888 is fully consistent with Order No. 636. Although the Commission in Order No. 888 chose a direct assignment method (rather than the cost-spreading approach in Order No. 636) for purposes of allocating stranded cost responsibility among customers, the approach used by the Commission in Order No. 888 is not governed by decisions in Order No. 636, but in either event the Commission must demonstrate that its choice of methods is based on reasoned decision-making.

In considering the stranded cost issues that may arise in the transition to competitive markets, the Commission also has taken cognizance of significant changes involving retail customers and the stranded cost issues that arise as retail customers convert to wholesale customer status (*e.g.*, through municipalizations) in order to obtain the open access afforded by Order No. 888, or as they obtain retail wheeling required by state commissions. These situations involve new and complex jurisdictional issues and represent the bulk of potential stranded costs facing the industry. We believe it is important to clarify the Commission's decisions as to when it will entertain requests for stranded cost recovery in these situations, and our reasons for doing so.

The Commission's determination that it, rather than the states, should be the primary forum for addressing stranded costs associated with a retail-turned-wholesale customer[479] is limited to those cases in which there is a *direct nexus* between the availability and use of Commission-required transmission access and the stranding of costs. We believe we have both the authority and the obligation to provide an opportunity for stranded cost recovery in these situations because the bundled retail customer would not be able

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[479] In Order No. 888 and here, we sometimes use the shorthand expression "retail-turned-wholesale" customer. By this we do not mean that a retail customer who is an ultimate consumer ceases to be an ultimate consumer, or that this customer begins to purchase electric energy for resale. Rather, in a "retail-turned-wholesale customer" situation, such as the creation of a municipal utility system, a newly-created entity becomes a wholesale power purchaser on behalf of retail customers who were formerly bundled customers of the historical local utility power supplier. The new municipal utility is the conduit by which retail customers, if they cannot obtain direct retail access, can reach power suppliers other than their historical local utility power supplier. Although the retail customers remain bundled retail customers, in that they become the bundled customers of the new entity, we call this a "retail-turned-wholesale customer" situation because the new entity in effect "stands in the shoes" of the retail customers for purposes of obtaining wholesale transmission access and new power supply.

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to obtain access to the new supplier *but for* the Commission's order requiring transmission. The creation of a new wholesale entity to purchase power on behalf of retail customers would not, by itself, trigger stranded costs. In the absence of transmission access from the historical supplier of the retail customers, the new entity would ~~have to~~ remain on the historical supplier's generation system because it would have no way to reach other power suppliers, and stranded costs would not occur.[480] Therefore, there is a causal nexus between the stranded costs and the availability and use of the tariff services *required by the Commission.*[481] Moreover, because of this causal nexus between the use of a jurisdictional utility's Commission-required transmission tariff and the potential for foregone revenues by that jurisdictional utility as a result of the Commission-required access, the stranded costs associated with a retail-turned-wholesale customer are properly viewed as economic costs that are jurisdictional to this Commission.

In contrast, in the situation in which a bundled retail customer obtains retail wheeling, stranded costs are directly

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[480] Exceptions would be self-generation or construction by the new entity of its own transmission line, in which case, as noted earlier, the stranded cost provisions of Order No. 888 would not apply because such options have always been available as alternatives to purchasing power from the historical supplying utility and do not involve the use of the utility's transmission facilities under an open-access tariff. Thus the departure of customers under these circumstances cannot be linked to the open-access requirements of this Rule.

[481] As discussed in greater detail in sections IV.J.6 and IV.J.12 below, we clarify that the opportunity for recovery of stranded costs in a retail-turned-wholesale situation is limited to cases in which the former bundled retail customer subsequently becomes, either directly or through another wholesale transmission purchaser, an unbundled wholesale transmission services customer of its former supplier. We have revised section 35.26(b)(1)(i) of the Commission's regulations accordingly.

caused by the availability and use of unbundled retail services *required by the state commission*, not this Commission.[482] Thus, the Commission believes that states, not the Commission, should be the primary forum for costs associated with a bundled retail customer that obtains retail wheeling. The Commission's decision to entertain requests to recover stranded costs caused by retail wheeling in *only* a limited circumstance (where the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required) is based on a policy decision by this Commission that it will step in to fill a regulatory "gap" that could result in no effective forum in which utilities would have an opportunity to seek recovery of prudently incurred costs.

Finally, after considering various proposals regarding how stranded costs should be calculated, and reviewing the arguments of petitioners on rehearing, the Commission continues to believe that the revenues lost approach is the fairest and most efficient way to determine the amount of stranded cost assigned to a departing customer during the transition to a competitive wholesale bulk power market. The Commission has rejected an asset-by-asset approach as overly complicated and costly.

We respond below to the specific arguments raised on rehearing and elaborate on the above determinations.

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[482] Unbundled retail transmission services required by a state commission could be taken under the same *pro forma* open-access tariff used by wholesale customers or, if determined appropriate by the Commission, under a separate retail tariff filed at the Commission. The critical point, however, is that in either case, the unbundled services are required by the state and not by this Commission.

Rehearing Requests Opposing Retail-Turned-Wholesale Jurisdiction

A number of entities challenge the Commission's assertion that costs associated with retail-turned-wholesale customers would not be stranded but for the FERC-jurisdictional transmission access requirement. They assert that the condition precedent to municipalization is the operation of a state process, and thus that it cannot be the case that the recovery of costs caused by a retail-turned-wholesale customer is "not subject to regulation by the States." They submit that such costs would not be stranded but for the action of state legislators or state regulators in granting authority for the customer's status change. They argue that any nexus that the Commission's authority under the FPA has to wholesale transmission services subsequently provided to the new

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wholesale customer is entirely derivative of the state's action.[674]

A number of entities argue that jurisdiction over costs that are stranded when a retail customer becomes a wholesale customer should be left to the states because the facilities used to provide retail service to these retail customers were subject to state jurisdiction and were included in retail rate base when the service was rendered.[675] They argue that because the Commission had no jurisdiction over the public utility facilities and costs incurred to serve retail-turned-wholesale customers, it has no jurisdiction to address those public utility costs if they become stranded. Thus, according

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[674] *E.g.*, NARUC, TAPS, Nucor, Suffolk County, IL Com, Multiple Intervenors, APPA, CAMU, WI Com, NASUCA.

[675] *E.g.*, ELCON, IL Com, IN Com, American Forest & Paper, AR Com, MO/KS Coms, NJ BPU, Suffolk County, WY Com, VA Com, FL Com, NARUC, TAPS.

to these entities, the conversion of the customer from retail to wholesale does not simultaneously effectuate a conversion of the costs from retail to wholesale.

AR Com and MO/KS Coms submit that jurisdiction over the costs incurred for historical retail customers does not shift unless the parties themselves make those costs a part of their new wholesale contract. NY Com submits that the Commission should recognize the states' jurisdiction to set the *level* of stranded costs associated with retail-turned-wholesale customers to be recovered in wholesale transmission rates set by FERC. FL Com asserts that state authorities are in a better position to assess the extent of stranded facilities and their costs, and that the Commission's involvement should be limited to that requested by a state by petition.

OH Com states that the Commission's position on stranded costs associated with retail-turned-wholesale customers invites second-guessing of state commission determinations and encourages forum shopping by introducing more than one stranded cost treatment within a single state jurisdiction. It expresses concern that utilities may seek to creatively disaggregate into generation, transmission, and distribution companies in ways to deliberately recast traditional retail relationships as wholesale in an effort to obtain favorable regulatory treatment of stranded costs.

IN Com submits that Order No. 888's treatment of stranded costs associated with retail-turned-wholesale customers will discourage state legislatures from making municipalization more available. VT DPS and Valero argue that the threat of a stranded cost surcharge will erect a new barrier to the formation of municipal utilities. They note that the rule refers to one commenter's observation that, if Otter Tail could have made a stranded cost claim against the municipal utility that Elbow Lake planned to create, Otter Tail would not have needed to refuse to wheel and there

would never have been an *Otter Tail* case. They submit that the Commission never addressed whether, or why, it believed the point to be wrong.

VT DPS and Valero also assert that the rule represents a major inconsistency with prior Commission treatment of municipalization. They submit that the Commission historically promoted franchise competition between municipalities and utilities by holding tariff provisions that restrict such competition to be anticompetitive and unreasonable.[676]

American Forest & Paper submits that recovery of 100 percent of stranded costs caused by municipalization is inconsistent with the Commission's actions in the natural gas industry, where the Commission has encouraged competition at the retail level through competitive bypass and has not created barriers to competitive entry by imposing transition charges or exit fees on converting customers.[677]

Nucor objects that the rule does not address the substantive findings, the common sense rationale, or the jurisdictional distinction drawn in *United Illuminating*.[678]

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It contends that the Commission's observation in Order No. 888 that there may not be a state regulatory forum for the recovery of stranded costs associated with retail-turned-wholesale customers and hence that the Commission should

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[676] VT DPS and Valero cite in this regard *Florida Power & Light Company*, 8 FERC ¶61,121 (1979); *Power Authority of the State of New York v. FERC*, 743 F.2d 93 (2d Cir. 1984); *Metropolitan Transportation Authority v. FERC*, 796 F.2d 584 (2d Cir. 1986).

[677] American Forest & Paper cites in support of its position *Great Lakes Gas Transmission Limited Partnership*, 68 FERC ¶61,376 (1994).

[678] *United Illuminating Company*, 63 FERC ¶61,212, *reh'g denied*, 64 FERC ¶61,087 (1993) (*United Illuminating*).

be the primary forum for addressing such stranded costs is flawed because there always is a state forum to address such cost recovery (the adequacy of the relief provided is a very distinct issue) and open-access transmission does not and cannot cause retail competition to occur.[679]

Commission Conclusion

We will reject the requests for rehearing of our decision to be the primary forum for addressing the recovery of stranded costs caused by retail-turned-wholesale customers. We find the requests for rehearing on this issue unpersuasive. While it may be the case, as some entities suggest, that state action is a condition precedent to municipalization, the rehearing petitions ignore the fact that the rule covers situations in which open access is *also* a condition precedent to the municipalized customers leaving their existing supplier's system. Order No. 888 does not propose that the Commission be the primary forum for stranded cost recovery for all cases of municipalization. Instead, our holding is limited to those cases in which the new wholesale entity uses Commission-mandated transmission access to obtain new power supply on behalf of retail customers that were formerly supplied power by the utility providing the transmission service.[680]

As we explained in Order No. 888, in such cases there is a direct nexus between the FERC-jurisdictional transmission access requirement and the exposure to non-recovery of costs

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[679] *See also* Suffolk County Rehearing (Commission's analysis in *United Illuminating* was correct; nothing has changed to warrant the Commission's rejection of that analysis).

[680] In the case of municipalization, the bundled retail customers of a local utility become the bundled retail customers of the new municipal utility. As explained above, we call this a "retail-turned-wholesale customer" situation because the new municipal entity in effect "stands in the shoes" of the retail customers for purposes of obtaining wholesale transmission access and new power supply.

stranded as a result of this wholesale transmission access. Thus, the stranded costs associated with retail-turned-wholesale customers for which Order No. 888 provides an opportunity for recovery would not have been incurred *but for* the action of this Commission in requiring a utility to make unbundled transmission services available. In these cases, the former bundled retail customers of the historical supplying utility (now the bundled retail customers of the new municipal system) would not have obtained access to new power supply *but for* the Commission's order mandating transmission. Without the regulatory mandate to provide access, the utility would have indirectly continued sales to the same retail customers because the new municipal utility purchasing power on the retail customers' behalf would have had no way to reach other power suppliers. In this situation, there would be no stranded generation costs. In other words, the creation of a municipal utility intermediary to purchase power at wholesale would not, by itself, trigger stranded costs. Rather, it is the access from the historical supplier of the bundled retail customers that is the condition precedent to reaching other power suppliers and thereby triggering stranded costs. Therefore, there is a clear causal nexus between the stranded costs and the availability and use of the tariff *required by the Commission.*

Costs that are exposed to nonrecovery when a retail customer or a newly-created wholesale power sales customer ceases to purchase power from the utility and *does not* use the utility's transmission system to reach a new generation supplier (*e.g.*, through self-generation or use of another utility's transmission system) do not meet the definition of "wholesale stranded costs" for which the rule provides an opportunity for recovery. Such costs are outside the scope of the rule because such costs would not be stranded as a direct result of the new open access.

In response to the argument that conversion of a customer from retail to wholesale would not simultaneously

effectuate a conversion of the costs from retail to wholesale, we believe this argument confuses

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the issue. We note that we have defined stranded costs as wholesale or retail on the basis of whether wholesale or retail open access is the cause of the costs being stranded, not on the basis of the original retail or wholesale characteristic of the costs. Thus, even though costs may have been originally incurred as retail-related costs, the precipitating event that results in such costs being stranded in the retail-turned-wholesale customer scenario is the use by the new wholesale customer of the Commission-mandated tariff. When a customer is able to use the Commission-required tariff to reach another generation supplier, it causes the utility to incur an economic cost in providing transmission service that is equal to the foregone revenues that the utility reasonably expected to receive under a state regulatory regime. Thus, because of the causal nexus between the use of a former supplying utility's Commission-mandated transmission tariff and the potential for foregone revenues by that utility as a result of the Commission-required access, the costs stranded by a retail-turned-wholesale customer are properly viewed as economic costs that are jurisdictional to this Commission.

In response to those entities that express concern that the Commission's position on stranded costs associated with retail-turned-wholesale customers invites second-guessing of state commission determinations, we emphasize that we have assumed primary authority to address such costs only in a limited category of cases where there is a direct nexus between the availability of Commission-required open access and the stranding of costs when the former customer uses the former supplying utility's transmission system (through its open-access tariff or a section 211 order) to reach a new supplier. We indicated in Order No. 888 that if the state has permitted any recovery from departing retail-turned-wholesale customers, such amount will not be stranded for

purposes of this Rule. We will deduct that amount from the costs for which the utility will be allowed to seek recovery under this rule from the Commission. In so doing, however, we are not second-guessing the states as to what a utility may recover under state law. Additionally, we will give great weight in our proceedings to a state's view of what might be recoverable.

We also reject the argument that the Commission's position on stranded costs associated with retail-turned-wholesale customers encourages forum shopping. To the contrary, as we said in Order No. 888, to avoid forum shopping and duplicative litigation of the issue, we expect parties to raise claims before this Commission in the first instance. We believe that this Commission should be the primary forum because, without the open access provided by the Rule, the new municipal utility would not be able to reach a new supplier and, as a result, would not cause the utility to incur stranded costs (as defined in this Rule).

We reject as misplaced arguments that the rule represents a major inconsistency with the Commission's historical promotion of franchise competition between municipalities and utilities and that it will discourage municipalization.[681] It continues to be the Commission's policy to encourage competition. Indeed, the goal of Order

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[681] In response to VT DPS and Valero, we note that whether or not Otter Tail may have agreed to wheel power for the municipal utility that Elbow Lake planned to create if Otter Tail could have made a stranded cost claim against that municipal utility is of no moment to the Commission's decision in Order No. 888 to allow utilities the opportunity to seek recovery of stranded costs associated with retail-turned-wholesale customers. The Court in *Otter Tail* did not address the stranded cost issue because it was not presented in that case. Nor was the Court presented with the extraordinary circumstances—the historic statutory and regulatory changes, including the requirement of open access, that have converged to fundamentally change the obligations of utilities and the markets in which they operate—that have justified this Commission's Order No. 888 stranded cost policy.

No. 888 is to remove impediments to competition in the wholesale bulk power marketplace and to bring more efficient, lower cost power to the Nation's electricity consumers. However, the purpose of the stranded cost policy is neither to encourage nor to discourage municipalization, but rather to facilitate a fair transition to competition and to ensure stability in the industry during that transition. As we discuss elsewhere in this order, we believe that this Commission must address the recovery of the costs of moving from a monopoly-regulated regime

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to one in which all sellers can compete on a fair basis and in which electricity is more competitively priced. On this basis, we believe that if a new wholesale entity such as a municipal utility uses Commission-required open access to reach a new supplier on behalf of its retail customers (previously retail customers of the former supplier), the former supplying utility should be given an opportunity to recover legitimate, prudent and verifiable costs that it incurred under the prior regulatory regime to serve that customer.

In response to American Forest & Paper's argument that recovery of 100 percent of stranded costs caused by municipalization is inconsistent with the Commission's policy in the natural gas industry of allowing competitive bypass without imposing transition charges or exit fees on converting customers, we note that industrial gas customers who bypass a local distribution company's (LDC) facilities do not escape transition costs quite so easily as suggested by American Forest & Paper. It is true that, when the end-user bypasses the LDC to reach an interstate pipeline different from the pipeline serving the LDC, the Commission views the bypass as a risk of competition from which the LDC should not be shielded.[682] However, when the end-user

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682 *Texas Gas Transmission Corporation*, 65 FERC ¶61,275 (1993).

bypasses the LDC to reach the same interstate pipeline that serves the LDC, the Commission may take certain actions to minimize adverse effects on the LDC and its remaining customers.[683] Moreover, an end-user that bypasses an LDC to reach the same pipeline that serves the LDC would, in any event, be allocated a share of the pipeline's gas supply realignment costs (if any), since those costs are allocated based on current contract demand (or usage).[684] Accordingly, we see no inconsistency between our bypass policy for the natural gas industry and Order No. 888's treatment of stranded costs associated with retail-turned-wholesale customers. Similar to our refusal to shield LDCs from the adverse effects of an end-user's bypass to reach a different pipeline than serves the LDC, Order No. 888 does not provide an opportunity for stranded cost recovery where a retail-turned-wholesale customer uses another utility's transmission system to reach a new supplier. As we note above, the opportunity for recovery of stranded costs associated with retail-turned-wholesale customers is limited to those cases in which the former retail customer obtains (either directly or through another wholesale transmission purchaser) unbundled transmission services from its former supplying utility. In the case of an end-use customer bypassing the LDC to reach the same pipeline that serves the LDC, the end-use customer would similarly be allocated a

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683 *Texas Gas Transmission Corporation*, 69 FERC ¶61,245, *reh'g*, 70 FERC ¶61,207 (1995) (requiring pipeline to offer LDC a reduction in its contract demand).

684 *See Southern Natural Gas Company*, 75 FERC ¶61,046, at p. 61,158 (1996); *Arcadian Corporation v. Southern Natural Gas Company*, 67 FERC ¶61,176, at p. 61,538 (1994). *See also United Distribution Companies*, 88 F.3d at 1181. As the *United Distribution Companies* court noted, the Commission has given an LDC relief (and required the bypassing customer to bear its share of transition costs) if the LDC can show a direct nexus between the bypass and the pipeline, although the Commission has declined to adopt a generic rule addressing this issue. 88 F.3d at 1180-81.

share of the pipeline's gas supply realignment costs. As a result, American Forest & Paper's attempt to rely on the Commission's gas bypass policy is misplaced.

We also disagree with those entities that argue that the Commission has failed to adequately distinguish Order No. 888's treatment of stranded costs associated with retail-turned-wholesale customers with the Commission's decision in *United Illuminating*. As we stated in Order No. 888, we recognize that we took a different approach to stranded cost recovery associated with retail-turned-wholesale customers in *United Illuminating*, where we suggested that state and local regulatory authorities or the courts should be able to provide an adequate forum to address retail franchise matters, including recovery of stranded costs caused by municipalization, but said we would consider revisiting the question if United Illuminating could demonstrate the lack of a forum.[685] However, we explained that since the issuance of that decision we have had an opportunity to re-analyze the nature of the stranded cost problem when a retail customer

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becomes a wholesale customer, including the potential that there might not be a state regulatory forum for recovery of such costs. In these circumstances, we have determined that where such costs are stranded as a direct result of Commission-mandated wholesale transmission access, these costs should be viewed as costs of the transition to competitive wholesale bulk power markets and this Commission should be the primary forum for addressing their recovery.

In response to Nucor's objection that there always is a state forum to address stranded cost recovery associated with retail-turned-wholesale customers, with the adequacy of the relief being a distinct issue, we clarify that our primary

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[685] 63 FERC at pp. 62,583-84.

concern in retail-turned-wholesale situations is not whether there is an adequate state regulatory forum for the recovery of stranded costs associated with retail-turned-wholesale customers. Rather, our primary concern is that wholesale customers (whether or not formerly retail) should be responsible for the costs incurred to meet their power needs that are stranded when they use the wholesale transmission ordered by this Commission to reach new suppliers. Our decision to be the primary forum in the case of stranded costs associated with retail-turned-wholesale customers is based on the causal nexus between regulatory-mandated wholesale transmission access and the stranding of costs when a new municipal utility uses such access to obtain new power supply on behalf of retail customers previously served by the former supplying utility.

Rehearing Requests Seeking Expansion of Retail-Turned-Wholesale Jurisdiction

Other entities seek rehearing of the Commission's decision not to be the primary forum for stranded cost recovery in situations in which an existing municipal utility annexes territory served by another utility or otherwise expands its service territory.[686] A number of them argue that the loss of existing retail customers through municipal annexations or expansions is no different from the loss of retail customers through new municipalization because existing municipal systems are likely to use Commission-jurisdictional open-access transmission to obtain resources to supply power to the annexed loads.[687] They submit that, just

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[686] *E.g.*, EEI, SoCal Edison, Centerior, Atlantic City, PSE&G, Puget, Public Service Co of CO, Coalition for Economic Competition.

[687] *E.g.*, EEI, SoCal Edison, PSE&G, Puget, Public Service Co of CO, Coalition for Economic Competition. Coalition for Economic Competition suggests, for example, that villages and large industrial customers may opt to join existing municipal systems that, in most cases, will use Commission-jurisdictional transmission tariffs to obtain resources to supply power to the annexed loads.

as with newly-municipalized customers, such costs would not be stranded but for the action of this Commission.

Some of these entities express concern that the rule will encourage retail-turned-wholesale transactions to be undertaken as annexations rather than through the formation of new entities to avoid stranded costs.[688] Public Service Co of CO contends that Order No. 888, in conjunction with the Commission's section 211 order in *American Municipal Power Ohio, Inc.*,[689] may facilitate municipal annexations by enabling municipal systems to serve new territory through the establishment of second delivery points.

Coalition for Economic Competition and Puget also argue that the Commission must consider stranded costs that arise from municipal expansion in order to satisfy its statutory obligation under the FPA to "set just and reasonable" rates. They contend that there is no justification for charging one rate to former retail customers taking transmission services through a new municipal utility and another rate to those taking service through municipal annexation or through use of another utility's transmission system.

PSE&G suggests that the distinction between new municipalization on the one hand and municipal annexation or expansion on the other hand may lead to unnecessary controversy and litigation as entities wrangle over whether a given expansion/annexation is really an expansion or a municipalization. It says that a situation could arise where a municipality

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[688] *E.g.*, EEI, Coalition for Economic Competition, Atlantic City, Puget, Public Service Co of CO.

[689] 74 FERC ¶61,086, *final order directing transmission service*, 76 FERC ¶61,265 (1996).

serves one town in order to serve thousands of additional customers in a second town. According to PSE&G, it is not clear from the rule whether the Commission would consider this an expansion of a municipality's service territory or a new municipalization.

Puget submits that the stranded cost recovery mechanism must not be subject to being frustrated by simple artifices such as having the new supplier (instead of the departing customer) request and contract for transmission service. SoCal Edison seeks clarification of the Commission's authority to mandate stranded cost recovery if a retail customer disconnects from a utility's system and accesses another generation supplier by interconnecting with a public power entity (who in turn would interconnect with a neighboring jurisdictional utility). It asks the Commission to clarify that such a transaction effectively constitutes a municipalization, not an expansion of a service territory, and that the Commission, under FPA section 211, can compel the recovery of stranded costs by having the "new" jurisdictional utility assess a stranded cost charge and pass the revenues on to the utility from whose system the customer departed.

SoCal Edison seeks several additional clarifications. It states that it understands that the Commission's primary forum status in no way prevents or interferes with a state's authority to order stranded cost recovery from departing retail customers. If this is not the case, SoCal Edison seeks rehearing on this issue. SoCal Edison also asks the Commission to clarify that the Commission retains the discretion to defer to a state stranded cost calculation methodology if appropriate to do so on the facts of a particular case.

Commission Conclusion

We have carefully reviewed the arguments made by petitioners seeking rehearing of our decision not to be the primary forum for stranded cost recovery in the case of

municipal annexations. Based on that review we have decided to reconsider our decision. This conclusion is based in large part upon the very significant similarities between the creation of a *new* municipal utility system (also referred to as municipalization) and the expansion of an *existing* municipal utility system (*e.g.*, through annexation of additional retail service territory). We recognize that the *same nexus* to Commission-required transmission access that forms the basis for our decision to allow a utility to seek stranded cost recovery in cases of new municipalization—use of the former supplying utility's transmission system—is likely to be present in some cases of municipal annexation. In the case of both new municipalizations and annexations, the bundled retail customers of a local utility become the bundled retail customers of a municipal utility (in one case a new municipal utility, in the other an existing municipal utility) *that will use the transmission system of the retail customers' former supplier in order to access other suppliers.*

As we explain above, in a "retail-turned-wholesale customer" situation, such as the creation of a municipal utility system, a newly-created entity becomes a wholesale power purchaser on behalf of the retail customers. It is the conduit by which retail customers, if they cannot obtain direct retail access, can reach power suppliers other than their historical local utility power supplier. Although the retail customers remain bundled retail customers, in that they become the bundled customers of the new entity, we call this a "retail-turned-wholesale customer" situation because the new entity in effect "stands in the shoes" of the retail customers for purposes of obtaining wholesale transmission access and new power supply. The same analogy applies to newly-annexed customers; they become "new" wholesale customers in the sense that the wholesale entity obtains transmission and new power supply on their behalf.

Accordingly, we clarify that this Commission will be the primary forum for addressing the recovery of stranded costs if an existing municipal utility uses the transmission system of its annexed retail customers' former supplier to access new suppliers to serve the annexed load. As long as Commission-required transmission access (the former supplier's open-access tariff or transmission services ordered under FPA section 211) is the vehicle that enables an existing municipal utility to obtain power supplies to serve annexed loads, we believe that any costs stranded as a result of this wholesale transmission access are properly viewed as economic costs that are jurisdictional to this Commission.

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In such a case, the bundled retail customers that are annexed by an existing municipal utility would, through the municipal utility, use the transmission system of their former supplier to obtain access to new supplies and thereby expose their former supplier to non-recovery of prudently incurred costs. As in the case of new municipal systems that use the transmission system of their retail customers' former supplier, such costs would not be stranded *but for* the action of this Commission in requiring a utility to make unbundled transmission services available.[690]

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690 SoCal Edison requests clarification that a transaction in which a retail customer disconnects from a utility's system and accesses another generation supplier by interconnecting with a public power entity, who in turn would interconnect with a neighboring jurisdictional utility, constitutes a municipalization, not an expansion of a service territory. Because we have decided to treat municipal annexations (or expansions) and new municipalizations similarly for purposes of stranded cost recovery under the Rule, SoCal Edison's request is moot to the extent that it envisions a scenario in which the former supplier's transmission system is used to access a new generation supplier. However, as discussed below, the rule would not provide an opportunity to seek recovery of stranded costs if the municipal entity in the scenario described by SoCal Edison *does not* use the former supplier's transmission system.

Just as we will not be the primary forum for stranded cost recovery for *all* new municipalizations, so also we will not be the primary forum for stranded cost recovery for *all* cases of municipal annexation. Instead, our holding is limited to those cases in which the existing municipal system uses Commission mandated transmission access from the annexed customers' former supplying utility to obtain power from a new supplier. Costs that are exposed to nonrecovery when an existing municipal utility *does not* use the transmission system of the retail customers' former supplier to reach a new generation supplier (*e.g.*, through self-generation or use of another utility's transmission system) do not meet the definition of "wholesale stranded costs" for which the rule provides an opportunity for recovery. Such costs are outside the scope of the rule because such costs would not be stranded as a direct result of Commission-required transmission access.

We reject as misplaced the argument that the Commission, by failing to address costs that arise if a municipal utility (whether a new municipal utility or an existing municipal utility that annexes additional retail customer territory) does not use the historical supplying utility's transmission system, has not met its statutory obligation to "set just and reasonable" rates. The Commission in this rulemaking has not determined any utility's just and reasonable rates. Further, Order No. 888 does not by its terms bar the recovery of costs that do not result from the use of Commission-required transmission access. Utilities may, as before, seek recovery of such non-open-access-related costs on a case-by-case basis in individual rate proceedings. The Commission will not prejudge those issues here.

As we indicated in Order No. 888, we also are concerned that there may be circumstances in which customers and/or utilities could attempt, through indirect use of open-access transmission, to circumvent the ability of any regulatory

commission—either this Commission or state commissions—to address recovery of stranded costs.[691] We reiterate that we reserve the right to address such situations on a case-by-case basis.

We share the concern expressed by Puget that a retail-turned-wholesale customer should not be allowed to avoid any stranded cost obligation that it may have under Order No. 888 simply by having its new supplier be the entity that requests and contracts for transmission service from the former supplying utility. We clarify that the opportunity for recovery of stranded costs associated with retail-turned-wholesale customers under Order No. 888 applies if the transmission system of the former supplier is used to transmit the newly obtained power supplies to the departing retail customer, regardless of whether the customer *or* its new supplier is the actual entity that requests and contracts for the unbundled transmission service. We have revised the definition of "wholesale stranded cost" in section 35.26(b)(1)(ii) accordingly to include

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the situation in which the retail customer subsequently becomes, either directly or through another wholesale transmission purchaser, an unbundled wholesale transmission services customer of the former supplying utility.

We clarify in response to SoCal Edison's request that our decision to be the primary forum for recovery of stranded costs from retail-turned-wholesale customers is not intended to prevent or to interfere with the authority of a state to permit any recovery from departing retail customers, such as by imposing an exit fee prior to creating the wholesale entity. As we indicated in Order No. 888, if the state has permitted any such recovery from a departing retail-turned-wholesale

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691 *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,819; *mimeo* at pp. 536-37.

customer, that amount will not in fact be stranded. Accordingly, we will deduct that amount from the costs for which the utility will be allowed to seek recovery from this Commission.[692]

We clarify in response to SoCal Edison's request that the Commission has the discretion to defer to a state stranded cost calculation methodology. However, because we recognize that state retail access plans may present questions that need to be addressed on a case-by-case basis, we will consider whether to exercise that discretion on a case-by-case basis.

7. Recovery of Stranded Costs Caused by Retail Wheeling

In Order No. 888, we concluded that both this Commission and the states have the legal authority to address stranded costs that result when retail customers obtain retail wheeling in order to reach a different generation supplier, and that utilities are entitled, from both a legal and a policy perspective, to an opportunity to recover all of their prudently incurred costs.[693] We explained that this Commission's authority to address retail stranded costs (i.e., stranded costs associated with retail wheeling customers) is based on our jurisdiction over the rates, terms, and conditions of unbundled retail transmission in interstate commerce by public utilities, and that the authority of state commissions to address retail stranded costs is based on their jurisdiction over local distribution facilities and the service of delivering electric energy to end-users. Because it is a state decision to permit or to require the retail wheeling that causes stranded costs to occur, we decided we generally will leave it to state regulatory authorities to deal with any stranded costs

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692 *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,819; *mimeo* at p. 537.

693 *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,824-26; *mimeo* at pp. 553-58.

occasioned by retail wheeling. The only circumstance in which we will entertain requests to recover stranded costs caused by retail wheeling is when the state regulatory authority[694] does not have authority under state law to address stranded costs when the retail wheeling is required. In such a case, we will permit a utility to seek a customer-specific surcharge to be added to an unbundled transmission rate.

We noted that most states have a number of mechanisms for addressing stranded costs caused by retail wheeling. We indicated that rates for services using facilities used in local distribution to make a retail sale are state-jurisdictional, and that states will be free to impose stranded costs caused by retail wheeling on facilities or services used in local distribution. We also said that states may use their jurisdiction over local distribution facilities or services to recover so-called stranded benefits.

We stated that we believe our approach to stranded costs associated with retail wheeling customers represents an appropriate balance between federal and state interests that ensures that the rates for transmission in interstate commerce by public utilities (except in a narrow circumstance) will not be burdened by retail costs.

We expressed concern about the cost-shifting potential in a holding company or other multi-state situation, where denial

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694 "State regulatory authority" has the same meaning as provided in section 3(21) of the FPA:

> " 'State regulatory authority' has the same meaning as the term 'State commission', except that in the case of an electric utility with respect to which the Tennessee Valley Authority has ratemaking authority (as defined in section 3 of the Public Utility Regulatory Policies Act of 1978), such term means the Tennessee Valley Authority."

of retail stranded cost recovery by a state regulatory authority could, through operation of the reserve equalization formula in a Commission-jurisdictional intra-system agreement, inappropriately shift the disallowed costs to affiliated operating companies in other states. We said that we will deal with such situations if they arise pursuant to public utility filings under section 205 or complaints under section 206. Thus, the need to amend a jurisdictional agreement to prevent stranded costs associated with retail wheeling customers from being shifted to customers in other states will be addressed on a case-by-case basis. We encouraged the affected state commissions in such situations to seek a mutually agreeable approach to this potential problem. If such a consensus solution resulted in a filing to modify a jurisdictional agreement, we indicated that we would accord such a proposal deference, particularly if other interested parties support the filing. In the event that the state commissions and other interested parties cannot reach consensus that would prevent cost shifting, we said that the Commission would ultimately have to resolve the appropriate treatment of such stranded costs.

Rehearing Requests Opposing Any Commission Involvement in Stranded Costs Associated With Retail Wheeling Customers

A number of entities dispute the Commission's statement that both it and the states have the legal authority to address stranded costs that result from retail wheeling. Central Illinois Light contends that the Commission's claim of dual jurisdiction is inconsistent with *FPC v. Southern California Edison Company.*[695] It says that the court in that case recognized that Congress meant to draw a bright line easily ascertained between state and federal jurisdiction, making unnecessary case-by-case analysis. Central Illinois

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[695] 376 U.S. 205, 215-16 (1964).

Light asserts that the Commission has stepped over the bright line into the states' exclusive jurisdiction over retail rates.

IA Com seeks rehearing of the Commission's assertion of concurrent jurisdiction with state authorities over stranded costs associated with retail wheeling customers on the ground that it is based on the Commission's erroneous assertion of jurisdiction over unbundled retail transmission.

IL Com says that regardless of whether the Commission's claim of jurisdiction over retail transmission is upheld, the Commission's ruling that there is joint jurisdiction over retail stranded costs is in error. According to IL Com, the Commission has no authority over such stranded costs. IL Com also disputes the Commission's characterization of the derivation of state authority to address such stranded costs. It says that state commission authority does not derive only from states' jurisdiction over local distribution facilities and the service of delivering electric energy to end-users. IL Com submits that state commission authority to address retail stranded costs derives from the existence of state commission jurisdiction over the facilities and costs at the time of their incurrence.

A number of entities contend that Commission jurisdiction over transmission facilities used in interstate commerce does not give it jurisdiction over stranded investment in retail generating assets.[696] Several argue that the fact that a retail wheeling customer might need transmission access from its former supplier does not change

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[696] *E.g.*, Central Illinois Light, IN Consumer Counselor, IN Consumers, Nucor, FL Com, WI Com, VA Com, AR Com, MO/KS Com, OH Com, APPA. For example, FL Com asserts that costs for facilities that are currently under the jurisdiction of state authorities do not become the Commission's jurisdiction because retail wheeling is instituted; in most cases, the states approved both the construction and the cost recovery for these facilities under bundled rate structures. FL Com submits that the states are in a better position to judge the extent and value of assets that may become stranded as a result of retail wheeling.

the character of the costs that are stranded. They maintain that retail stranded costs are not costs of providing unbundled transmission service, but are costs associated with providing what was formerly bundled retail service, over which the Commission has no jurisdiction.[697]

Several entities argue that it is solely the action of the state that allows a given

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utility's retail customers to seek alternative sources of supply; therefore, there is no nexus between the Commission's wholesale transmission rule and any costs that might be stranded by a state-established customer choice regime.[698]

A number of entities submit that the provision of FPA section 201 that federal regulation is "to extend only to those matters which are not subject to regulation by the States" bars any attempt by the Commission to displace or supplant an admittedly legitimate exercise of state authority over retail stranded costs.[699] NASUCA submits that all state commissions have the authority to establish just and reasonable rates for the retail electric utilities in their respective jurisdictions.[700] It maintains that only state

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[697] *E.g.*, APPA, AR Com, MO/KS Coms, OH Com.

[698] *E.g.*, NARUC, TAPS.

[699] *E.g.*, NASUCA, NY Com, WY Com, NARUC. The Consumer's Utility Counsel Division of the Georgia Governor's Office of Consumer Affairs filed comments on June 24, 1996, in support of NARUC's request for rehearing on the jurisdictional issues pertaining to the recovery of retail stranded costs. While answers to requests for rehearing generally are not permitted, 18 C.F.R. §385.213(a)(2) (1996), we will depart from our general rule because of the significant nature of this proceeding and will accept these comments.

[700] According to NASUCA, whether or not that authority includes a requirement that a utility receive 100 percent return on stranded costs (or

regulators are in a position to rule on the treatment of costs that were allowed in retail rates pursuant to state laws; the Commission has no knowledge or expertise regarding the specific state legal frameworks in which these costs were included in rates. NY Com argues that the Commission does not have jurisdiction to determine the rate treatment of costs devoted to retail service and, thus, lacks authority to allow recovery if a state decides not to do so.

VA Com argues that section 201(b)(1) of the FPA restricts the Commission's jurisdiction to wholesale sales. It says that a departing retail customer remains a retail customer, regardless of the supplier. VA Com concludes that no portion of the transaction is a wholesale sale, and that there are no wholesale costs associated with a retail wheeling transaction.[701]

A number of entities seek rehearing of the Commission's decision that it will entertain stranded cost claims when the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required.[702] NARUC submits that Congress did not intend the Commission to become involved in adjudicating legal questions regarding the breadth of state law authority granted state commissions by their legislatures. NARUC expresses concern that the Commission would second-guess a state cost recovery determination and promote forum shopping. Once a balance has been struck at the state level concerning the terms of restructuring, NARUC submits that it is inconceivable that the Commission would have either the

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something less) is a matter to be determined by the state courts and legislatures.

[701] *See also* AR Com (one retail transaction is replaced by another retail transaction; there is no wholesale transaction and no wholesale costs over which the Commission has jurisdiction).

[702] *E.g.*, NARUC, Central Illinois Light, IN Com, American Forest & Paper, IN Consumer Counselor, IN Consumers, IL Com.

desire or authority to second-guess a state's legislative and regulatory processes.

Several entities object that the Commission effectively would authorize recovery of stranded costs associated with a retail wheeling customer if a state legislature withholds from the state regulatory agency the authority to approve stranded cost recovery.[703] They submit that just because a state has not given its regulatory commission the authority to impose stranded costs in the case of retail wheeling does not confer jurisdiction on the Commission to impose such charges. They contend that the state legislature should be the final arbiter of state policy. IL Com submits that if a state legislature chooses not to give its state commission the authority to act on stranded costs, "that can be taken as a clear indication that the state's legislature most certainly does *not* want FERC to address them."[704] Central Illinois Light objects that the Commission has offered no reason why it will accept the decision of the

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regulatory agency, but not that of the legislature.

AMP-Ohio and Cleveland ask the Commission to clarify that its deference to the determinations of the states is to the authority of the states as exercised through state legislative bodies (and other political subdivisions with legislative authority) as well as to state regulatory bodies. They submit that if the state legislature, or a local government acting in accordance with its authority, enacts retail wheeling legislation that expressly limits the ability of its regulatory

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703 *E.g.*, Central Illinois Light, IN Com, American Forest & Paper, IN Consumer Counselor, IN Consumers, IL Com. TX Com considers that it has the power to address stranded cost issues related to retail transmission service.

704 IL Com at p. 38 (emphasis in original).

body to permit recovery of stranded costs, even barring all such recovery, the Commission should not become involved.

Several entities ask the Commission to clarify that Order No. 888 does not permit utilities to apply to the Commission for recovery of stranded costs associated with a retail wheeling customer when a state regulatory authority has "addressed" a request for the same stranded costs but has not allowed 100 percent recovery.[705] ELCON gives two hypothetical examples to which it asks the Commission to respond: one where a state regulatory authority possesses full stranded cost recovery authority but allows only 50 percent recovery; the other where the state legislature provides the state regulatory authority by statute with the power to permit recovery of up to 50 percent of identified stranded costs.

Commission Conclusion

We reaffirm our conclusion that both this Commission and the states have the legal authority to address stranded costs that result when retail customers obtain retail wheeling in interstate commerce from public utilities in order to reach a different generation supplier, but that, because it is a state decision to permit or require the retail wheeling that causes retail stranded costs to occur, we will leave it to state regulatory authorities to deal with any stranded costs occasioned by retail wheeling. The only circumstance in which we will entertain requests to recover stranded costs caused by retail wheeling is when the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required.

We will reject the requests for rehearing that oppose any Commission involvement in stranded costs associated with retail wheeling customers. We disagree with those entities that challenge our conclusion that both this Commission and the states have the legal authority to address stranded costs

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[705] *E.g.*, ELCON, NASUCA, IL Com, NY Com.

that result from retail wheeling (variously described by those entities as dual, concurrent, or joint jurisdiction). The Commission explained in detail in Order No. 888 the legal basis for concluding that this Commission and the state commissions each have jurisdiction over separate aspects of a retail wheeling transaction.[706] This Commission has jurisdiction over the rates, terms, and conditions of unbundled retail transmission in interstate commerce by public utilities. State commissions have jurisdiction over local distribution facilities and the service of delivering electric energy to end-users. Based on our respective jurisdictions over separate aspects of the retail wheeling transaction, we believe either has the authority to provide the former supplying utility with an opportunity to recover costs stranded when the departing customer uses retail transmission in interstate commerce to reach a new supplier, but that here, unlike the retail-turned-wholesale scenario, the state commission should be the primary forum because these costs are stranded by the action of the state. We would act only if the primary forum is not available. We have made a policy decision that this Commission will step in to fill a regulatory "gap" that could result in no effective forum under which utilities would have an opportunity to seek recovery of prudently incurred costs.

Several entities argue that the Commission does not have jurisdiction over stranded investment in retail generating assets, that use of Commission-jurisdictional transmission does not change the character of the costs that are stranded, that stranded costs associated with retail wheeling customers are not costs of providing unbundled transmission service,

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[706] *See FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,780-85; *mimeo* at pp. 427-42 and appendix G.

but are costs associated with providing what was formerly bundled retail service, and that only state regulators are in a position to rule on the treatment of costs that were allowed in retail rates pursuant to state laws. While we agree that stranded costs associated with retail wheeling are costs that are retail in character in the sense that they are in retail bundled rates and become stranded as a result of retail wheeling required by the state commission, we do not believe this precludes the Commission from exercising jurisdiction in the limited circumstances of the Rule.

As an initial matter, we note that there are rarely separate retail and wholesale generating facilities. Retail customers and wholesale requirements customers get energy from the same facilities, each buying a "slice of the system." Typically all generating assets go into both the retail and the wholesale rate bases for determining retail and wholesale rates. Rates are determined by allocating the total generating costs among customer classes. The parties confuse the issue before us to the extent they suggest that state commissions, not this Commission, have "jurisdiction" over certain "costs." Neither the state commissions nor this Commission has exclusive jurisdiction over "costs." Each regulatory authority has jurisdiction to determine "rates" for services subject to its jurisdiction and, in determining rates, may take into account all of the costs incurred by the utility. Under historical cost-of-service ratemaking, each regulatory authority, in exercising its respective *ratemaking* jurisdiction, reviews the *total* costs incurred by a utility to provide service and make its separate and independent determination of what costs may be recovered through rates within its jurisdiction.[707]

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[707] If a utility is regulated by both this Commission and a state commission, each commission, in setting cost-of-service rates within its jurisdiction, will separately and independently determine the utility's *total* cost of providing service (also known as the utility's total revenue requirement). This will be based on the expenses incurred in providing service and a reasonable profit on the utility's assets that are used to provide the service. The commissions may differ as to what assets are

Generating costs continually shift between retail and wholesale rates over time.[708]

More importantly, both the state commission and this Commission have a responsibility to oversee the financial health of the utilities we regulate. Each has jurisdiction to make judgments about recovery of the costs of the assets in the utility's total rate base. Utilities are entitled to a regulatory forum that can adjudicate claims that they are or are not entitled to recovery of costs incurred regardless of the initial retail or wholesale "character" of those costs, and we believe we have the authority and obligation to fill a regulatory "gap" that could occur.[709]

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appropriately included in total rate base, what other costs are appropriately included in the total cost of service, and what rate of return should be permitted. Once each regulatory authority has determined the appropriate total revenue requirement, it then will determine what portion of that total revenue requirement should be borne by the utility's wholesale customers and what share should be borne by retail customers (also-called cost allocation). Each commission may also reach different conclusions on this split as well. Thus, under historical cost-based ratemaking, regulatory authorities do not carve out so-called "wholesale costs" that only this Commission can take into account in determining rates subject to its jurisdiction or so-called "retail costs" that only a state commission can take into account in determining rates subject to state jurisdiction. Additionally, this Commission and state commissions have the discretion to determine whether costs are appropriately recovered through a transmission, generation, or distribution component of a rate (also-called functionalization of costs) within their respective jurisdictions.

[708] We reject arguments that stranded retail generation costs are not a cost of providing unbundled retail transmission. While such costs are not a cost of operating the physical transmission system, nevertheless, they are an economic cost incurred as a result of being required to provide retail transmission.

[709] This is not a regulatory "gap" in the sense that the Commission would be asserting authority over matters not within its jurisdiction. However, the Commission would be filling a regulatory "gap" to the extent that the utility normally would have the opportunity to seek

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In response to the argument that it is solely the action of the state that allows a retail customer to seek alternative sources of supply and, as a result, there is no nexus between the Commission's wholesale transmission rule and any costs that might be stranded by a state-established customer choice regime, we agree. Indeed, as we indicate in Order No. 888, we decided to leave it to state regulatory authorities to deal with any stranded costs occasioned by retail wheeling (with a limited exception) because it is a state decision to permit or require the retail wheeling in the first instance that causes retail stranded costs to occur. Our determination, as explained above, is to fill any regulatory gap that arises as a result of interstate wheeling. We believe that it is necessary for the Commission to act as a backstop in this limited instance to ensure that costs stranded as a result of retail wheeling do not go unrecovered because the state regulatory authority lacks the authority under state law to address such costs. At the same time, as we stated in Order No. 888, we believe that most states have a number of mechanisms for addressing stranded costs caused by retail wheeling. We emphasize that this rule is not intended to preempt the exercise of any existing state authority with respect to the assessment of a stranded cost or stranded benefits charge on a retail customer that obtains retail wheeling.

In response to arguments that the Commission's decision will result in second-guessing or interfering with a state's legislative processes and decisions, we believe these arguments are premature. As a general matter, we do not

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approval from its state regulatory commission to recover costs in retail rates from a departing retail customer or to reallocate those costs to other retail customers. In circumstances where the utility does not have this opportunity because the state regulatory authority has no authority to address the issue, we may appropriately fill this regulatory "gap" to permit recovery from the departing customer through the retail transmission rate.

expect that our decision to be a backstop will interfere with legislative decisions that specifically address stranded cost matters and the scope of the state regulatory authority's authority in determining stranded costs. If states or parties to a retail stranded cost recovery case brought before this Commission believe that a Commission decision on the issue would interfere with state legislative decisions, they should raise their arguments, and support therefor, at that time.

We clarify that Order No. 888 does not permit utilities to seek recovery from the Commission of stranded costs associated with retail wheeling customers if a state regulatory authority with authority to address retail wheeling stranded costs has in fact addressed such costs, regardless of whether the state regulatory authority has allowed full recovery, partial recovery, or no recovery.

Rehearing Requests Supporting Broader Jurisdiction Over Stranded Costs Associated With Retail Wheeling Customers

A number of entities seek rehearing of the Commission's decision not to serve as a backstop for all stranded costs associated with retail wheeling customers. Some assert that the Commission has the legal authority to address independently stranded costs that arise from retail wheeling and that the Commission cannot lawfully abdicate or delegate such authority to the states.[710] Coalition for Economic Competition submits that the Commission correctly concluded that it has jurisdiction over retail transmission rates, terms and conditions and the authority to address retail wheeling stranded costs. Thus, it argues that the Commission is without the power to make a "policy determination" that results in the Commission not exercising its legal authority over stranded costs associated with retail wheeling customers. It asserts that, just as the Commission recognizes

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[710] *E.g.*, Utilities For Improved Transition, Coalition for Economic Competition.

that it "cannot simply turn over its jurisdiction" to the states to determine facilities subject to Commission jurisdiction,[711] [711] the Commission cannot turn over its jurisdiction to establish stranded cost charges that it correctly determined it has the authority to establish. Coalition for Economic Competition argues that the Commission should adopt a stranded cost recovery policy similar to the policy the Commission has adopted with respect to the determination of state/federal jurisdiction, whereby the Commission would defer to state stranded cost determinations so long as they are consistent with the Commission's policy.

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Utilities For Improved Transition argues that the Commission's authority over public utility rates for the transmission of electric power, both wholesale and retail, is plenary and exclusive. As a result, it submits that the Commission may not avoid responsibility for costs stranded by transmission of retail power.[712] Illinois Power contends that Congress did not authorize the Commission to reject jurisdictional rate filings whenever the Commission regards the state commissions as a more convenient or appropriate forum.

EEI and the Coalition for Economic Competition contend that virtually all retail stranded costs can only occur through the vehicle of Commission-jurisdictional

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[711] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,784; *mimeo* at p. 439.

[712] Utilities For Improved Transition argues that, based on *Consolidated Edison Company of New York, Inc.*, 15 FERC ¶61,174, at p. 61,405 (1981) and other cases, the Commission has jurisdiction over the entire delivery service (rendered on both the transmission and local distribution facilities) as a transmission transaction. Utilities For Improved Transition submits that states do not have authority over rates on local distribution facilities used to complete a transmission transaction.

transmission in interstate commerce. They submit that the Commission, having recognized the clear nexus between FERC-jurisdictional transmission and stranded costs in the retail-turned-wholesale context, cannot fail to recognize the same clear nexus in the retail wheeling context.

Utilities For Improved Transition says that it is legally immaterial whether stranded costs are caused by the Commission's ordering the transmission or the states' doing so; the determining factor is who has the jurisdiction to make the rates for the service, not who has the jurisdiction to order the service.

Coalition for Economic Competition and Utilities For Improved Transition contend that the Commission must consider stranded costs that arise from retail wheeling in order to satisfy its statutory obligation under the FPA to "set just and reasonable" rates. Coalition for Economic Competition maintains that FPA sections 201, 205 and 206 do not give the Commission the flexibility to allow stranded costs in certain jurisdictional wheeling rates (*e.g.*, wholesale wheeling and new municipalizations) but to exclude them from other jurisdictional wheeling rates (*e.g.*, retail wheeling, municipal annexation, and bypass).[713] Utilities For Improved Transition says that the just and reasonable standard requires the Commission to backstop the states to ensure that there is full stranded cost recovery. It objects that Order No. 888's disposition of jurisdiction creates a problem of cross-class discrimination (wholesale versus retail) and inter-class discrimination (some retail versus the remainder of the retail).

Coalition for Economic Competition further argues that the Commission's failure to address all stranded costs associated with retail wheeling customers will result in an

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[713] EEI states that the Commission did not rebut EEI's argument that the Commission's failure to address all retail stranded costs was unduly discriminatory.

improper taking under the Constitution.[714] It also argues that the Commission is not permitted to disregard its findings in Order No. 888 which, according to Coalition for Economic Competition, "inexorably" lead to the conclusion that Commission action on "all" stranded costs (including retail wheeling, municipal annexation, and bypass stranded costs) is required.[715]

Illinois Power argues that the FPA does not authorize the Commission to discriminate among utilities based on the state of their residence, and that the Commission must allow all utilities to seek interstate rate recovery of just and reasonable retail stranded costs. Illinois Power asserts that the rule will lead to the absurd, unduly discriminatory result that utilities located in states whose legislatures have failed to provide for stranded cost recovery will be better off than those located in states that provide for only limited stranded cost recovery. It supports use of the Commission's statutory authority to establish a uniform, national method for retail stranded cost recovery.

Coalition for Economic Competition also contends that the Commission's decision

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to let the states deal with retail stranded costs is arbitrary and capricious because the Commission failed to consider the arguments that stranded cost opponents will make before state commissions, such as that a state lacks jurisdiction to impose stranded cost charges or that the state imposition of such charges may be preempted or found to be an undue burden on interstate commerce. It further argues that the

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[714] In support of its argument, Coalition for Economic Competition cites *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 602 (1944); *Duquesne Light Company v. Barasch*, 488 U.S 299, 307-08 (1989).

[715] Coalition for Economic Competition at p. 14.

Commission's reliance on state jurisdiction over the service of delivering electric energy to the end-user does not reflect reasoned decisionmaking. It submits that the Commission has failed to consider that the sale of electric energy may take place outside of the state into which the energy is transmitted, in which case the state commission may have no jurisdiction over either the sale or the transmission of the energy and, accordingly, no authority to consider stranded costs.

A number of entities ask the Commission to act on requests for retail stranded cost recovery when the state commission lacks authority *or* has authority to order recovery, but has declined to do so or has only allowed partial recovery.[716]

Lastly, TX Com notes that section 35.26(d) (dealing with recovery of retail stranded costs) refers only to public utilities. It suggests that the omission of a reference to transmitting utilities appears to be inadvertent and should be corrected.

Commission Conclusion

The Commission will reject the requests for rehearing of our decision not to assume a backstop role for all stranded costs associated with retail wheeling customers. We explained in Order No. 888 that commenters that describe our action as an unlawful abdication or delegation of authority misconstrue the nature of our decision to leave stranded costs associated with retail wheeling customers (with a limited exception) to state regulatory authorities.[717]

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716 *E.g.*, Centerior, Southern, SoCal Edison.

717 We also explained that the case law they cite (which they refer to again in their rehearing requests) to support the proposition that an agency is not authorized to abdicate its statutory responsibility or to delegate to parties and intervenors regulatory responsibilities is factually distinguishable and inapposite. *See FERC Statutes and Regulations,*

We have not "abdicated" or "delegated" to state regulatory authorities our jurisdiction over the rates, terms, and conditions of retail transmission in interstate commerce; if retail transmission in interstate commerce by a public utility occurs, public utilities offering such transmission must comply with the FPA by filing proposed rate schedules under section 205.[718] Instead, we have made a policy determination that the recovery of stranded costs associated with retail wheeling customers—an issue over which either this Commission or state commissions could exercise authority by virtue of their jurisdiction over retail transmission in interstate commerce and over local distribution facilities and services, respectively—is primarily a matter of local or state concern for which the primary forum should be the state commissions. However, if the state regulatory authority does not have authority under state law to be the forum to address stranded costs when the retail wheeling is required, then we will entertain requests to recover such costs. As we explain above in response to the rehearing petitioners that oppose any Commission involvement in stranded costs associated with retail wheeling customers, we have made a policy decision that this Commission will step in to fill a regulatory "gap"

Regulations Preambles January 1991-June 1996 at p. 31,825 and note 765; *mimeo* at pp. 554-55 and note 765.

[718] The entities who argue that the Commission has abdicated or delegated its jurisdiction to the states misconstrue the Commission's jurisdiction to determine rates for unbundled transmission in interstate commerce as somehow including exclusive "jurisdiction" over "costs." However, as discussed above, neither this Commission nor the state commissions has exclusive "jurisdiction" over "costs." Rather, each has jurisdiction to determine "rates" for services subject to its jurisdiction. It is in the course of determining "rates" for unbundled transmission in interstate commerce that this Commission can take into account various costs incurred by a utility to provide jurisdictional service. A state commission can take those same costs into account in making its separate and independent determinations of what costs may be recovered through rates within its jurisdiction. *See* note 707, *supra*, and accompanying text.

that could result in no effective forum under which utilities would have an opportunity

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to seek recovery of prudently incurred costs.[719]

We disagree with Coalition for Economic Competition's argument that our findings in Order No. 888 "inexorably" lead to the conclusion that Commission action on "all" stranded costs (including retail wheeling and bypass stranded costs) is required, much less that the Commission has ignored the findings in Order No. 888. To the contrary, as we explain in section IV.J.1, it is not the purpose of this rule to allow utilities an opportunity to seek to recover "all" uneconomic costs that might be stranded when a customer leaves its utility supplier. We have fully explained our reasons for adopting an approach that, for purposes of stranded cost recovery from wholesale transmission customers, relies on the nexus between stranded costs and the use of transmission tariffs required by this Commission and, for purposes of stranded cost recovery from retail customers, recognizes state commission jurisdiction but fills potential regulatory gaps that could arise in the transition to new market structures.

We disagree with those entities that contend that the Commission must consider retail stranded costs in order to satisfy our statutory obligation under the FPA to set just and reasonable rates. In determining just and reasonable rates for jurisdictional transmission service, which currently are determined on a cost basis, the Commission satisfies its statutory obligation under the FPA by allowing utilities an opportunity to recover their prudently incurred costs plus a

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[719] Based on these same considerations, we reject Coalition for Economic Competition's request that the Commission assume a backstop role for all stranded costs associated with retail wheeling customers but defer to state stranded cost determinations so long as they are consistent with the Commission's policy.

reasonable rate of return. As we have explained above, this may include the costs of use of the physical transmission system, as well as economic costs incurred by the utility when it provides transmission service (*e.g.*, stranded costs). However, in situations in which a state regulatory authority has the authority to address recovery of retail stranded costs, there is no regulatory "gap," and there is no obligation for this Commission to provide a second opportunity for recovery.[720]

We reject arguments that FPA sections 201, 205 and 206 do not give the Commission the flexibility to allow stranded costs in certain jurisdictional wheeling rates (wholesale wheeling and new municipalizations) but to exclude them from other jurisdictional wheeling rates (retail wheeling in interstate commerce and use of another utility's transmission tariff), and that this policy somehow makes rates discriminatory. Recovery of this type of cost through a transmission rate is obviously not the norm, but is necessitated by the need to deal with the transition costs associated with this Rule. As discussed in detail in the Rule, the Commission has carefully balanced the interests of utilities as well as customers in concluding that the opportunity for stranded cost recovery through transmission rates should be permitted in only two general circumstances: (1) in the case of wholesale stranded costs, where there is a direct nexus to Commission-required transmission access; and (2) in the case of retail stranded costs, where there otherwise would be a regulatory gap because a state regulatory authority lacks authority under state law to address stranded costs at the time that retail wheeling is required. We

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[720] If the state regulatory authority is the forum before which to seek recovery, the utility may make whatever arguments it wishes regarding the justness and reasonableness of its rates, as well as any unconstitutional taking arguments it may have, before the state forum. Further, it can pursue appeals of unfavorable decisions through the state court system.

see nothing in the FPA that precludes us from exercising this flexibility and, indeed, the parties have not pointed to anything that, in our opinion, precludes us from exercising this discretion.

We reject the argument that virtually all stranded costs associated with retail wheeling customers can occur only through the vehicle of Commission-jurisdictional transmission in interstate commerce, and therefore, that the same nexus between FERC-jurisdictional transmission and stranded costs that exists in the retail-turned-wholesale context is present in the retail wheeling context. We also

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disagree that it is legally immaterial whether stranded costs are caused by the Commission's ordering the transmission or the states doing so, and that the determining factor is who has the jurisdiction to make the rates for the service, not who has the jurisdiction to order the service. The opportunity for stranded cost recovery set forth in this rule is based on the causal link between stranded costs and the availability and use of the Commission-required transmission tariff. It is true that in both the retail-turned-wholesale context and the retail wheeling context there is a limited nexus between stranded costs and Commission-jurisdictional access since, in both situations, the Commission has jurisdiction over the rates, terms and conditions of the transmission service and, therefore, the authority to permit stranded cost recovery through the transmission rates. However, the *causal* nexus to FERC-jurisdictional transmission and stranded costs in the two contexts (retail vs. retail-turned-wholesale) is different. In the retail wheeling context, there is *no causal nexus* between stranded costs and transmission that has been *ordered by this Commission.* In the retail-turned-wholesale context, in contrast, the opportunity for a utility to seek recovery of stranded costs is grounded on the existence of a *direct causal nexus* between stranded costs and transmission that has been *ordered by this Commission.*

We will reject the rehearing petitions that ask the Commission to act on requests for stranded cost recovery associated with retail wheeling customers not only when the state commission lacks authority, but also when the state commission has authority but either has declined to use it or has only allowed partial recovery. As explained above, our decision to entertain requests to recover stranded costs caused by retail wheeling in a limited circumstance (when the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required) is based on our determination to fill any regulatory gap that arises in association with interstate transmission.

We will reject TX Com's request that the Commission clarify that section 35.26(d) (dealing with recovery of retail stranded costs), which refers only to public utilities, should also refer to transmitting utilities. The Commission's decision to act as a limited backstop in the case of stranded costs associated with retail wheeling customers is based on our jurisdiction under sections 205 and 206 of the FPA over the rates, terms, and conditions of retail transmission in interstate commerce. As a result, our ability to allow the recovery of such costs through a surcharge on a section 205 unbundled transmission rate is necessarily limited to public utilities.[721]

Rehearing Requests Opposing Commission Treatment of Stranded Costs Associated with Retail Wheeling Customers in Holding Company Intra-system Agreement Cases

A number of entities oppose the Commission's proposal to address on a case-by-case basis whether jurisdictional intra-system agreements may need to be amended in order to prevent inappropriate cost-shifting that could occur if one

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[721] We note that the definition of "retail stranded cost" in section 35.26(b)(5) mistakenly refers to "a public utility *or* transmitting utility" (emphasis added). We will revise the definition to remove the reference to "transmitting utility."

state disallows stranded cost recovery associated with retail wheeling customers. IN Com objects that the problem is not the actions of one state or another, but rather the terms of the intra-system agreement.

AR Com objects that Order No. 888 is factually in error because a state's treatment of retail stranded costs under the Entergy System Agreement cannot shift costs to other jurisdictions.[722] It submits that whenever retail load changes, whether due to retail wheeling or any other factor, responsibility ratios under Entergy's reserve equalization schedule, MSS-1, will change and costs will shift irrespective of the regulator's treatment of retail stranded costs. AR Com says that MSS-1 reveals no changes in calculations due to retail treatment of stranded costs or any other retail ratemaking; only

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"excess" capacity costs of intermediate gas- and oil-fired plant are "shifted" under the Entergy System Agreement. Although the Commission has the authority to amend intra-system agreements when wholesale cost allocations have become unjust and unreasonable, AR Com submits that the Commission does not have jurisdiction to reach to the state level and dictate what retail ratepayers should pay to shareholders. AR Com maintains that a FERC-jurisdictional intra-system agreement extends only to sales for resale (transactions among subsidiaries), and that if a holding company believes that an intra-system agreement is unduly discriminatory as a result of a state's disallowance of costs, the holding company can propose to amend it.[723]

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[722] *See also* MO/KS Coms (the cost-shifting problem does not arise because of a particular state treatment of stranded costs; it arises because Entergy insists on recovering 100 percent of its costs even when some portion of the costs are not economical).

[723] AR Com also objects to the Commission's description of the issue as involving not only holding companies, but also other multi-state

AR Com argues that retail stranded costs fall to state jurisdiction regardless of whether the utility is a member of an interstate holding company. AR Com says that because the costs at issue are in retail rate base, any Commission influence over their recovery could occur only through preemption, but preemption of a state disallowance from retail rate base is possible only if there is a "trapped cost." AR Com submits that a disallowance of retail rate base cost cannot result in a trapped cost because there is no inconsistency between two agencies acting within their jurisdiction; the Commission has no jurisdiction to act. AR Com maintains that, unlike the Grand Gulf situation, the Commission has not mandated any Entergy generation costs into retail rate base. It further says that different state decisions regarding recovery of retail costs are not inconsistent decisions; they represent each state applying its law to its facts. According to AR Com, decisions by states leading to less than full recovery could be deemed inconsistent decisions only if there were a federal guarantee of full cost recovery of retail costs, which there is not.

AR Com and MO/KS Coms assert that the Commission's proposal for holding company situations cannot apply to future holding companies, where there is no history of joint planning justifying cost equalization, nor can it apply to future investments. They contend that this would require an assumption that the utility subsidiaries of a registered holding company have planned, and should plan, together rather than separately (i.e., that interaffiliate transactions are always more efficient than nonaffiliate transactions), and that such assumption would be sound only

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situations. AR Com says that "[t]he mere fact that a company's territory crosses state lines does not automatically mean that all assets serve all customers, or that all customers are required to bear the economic risk associated with all assets, or that assets that at one time were solely state-jurisdictional can somehow, by virtue of a company's decision to expand across state lines, become FERC-jurisdictional." AR Com at p. 11.

if having the transaction occur between affiliates is inherently more efficient than having the transaction occur between an affiliate and a nonaffiliate.

Commission Conclusion

The comments raised for the most part are either premature or reflect a misunderstanding of the Commission's decision. Contrary to AR Com's argument, the Commission in Order No. 888 in no way asserted jurisdiction over state determinations of stranded costs associated with retail wheeling customers. We agree with AR Com that our jurisdiction extends only to sales for resale (and transmission in interstate commerce) and that a holding company can seek to amend an intra-system agreement if it believes the agreement is unduly discriminatory as a result of a state's disallowance of costs. However, a holding company also may seek to amend an agreement *before* any potential disallowances can occur, to keep cost-shifting from occurring. The fact is that intra-system agreements which involve wholesale sales among affiliate companies in different states could, through operation of their reserve equalization formulas, result in customers in one or more states having to indirectly bear stranded costs that are disallowed in another state, and the Commission has a responsibility to prevent inappropriate cost-shifting. Such determinations can be made only on a case-by-case basis. Again, as we stated in Order No. 888, we encourage affected state commissions to propose mutually agreeable solutions to this potential problem.

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8. Evidentiary Demonstration Necessary—Reasonable Expectation Standard

In Order No. 888, the Commission concluded that a utility seeking to recover stranded costs must demonstrate that it had a reasonable expectation of continuing to serve a customer. We stated that whether a utility had a reasonable

expectation of continuing to serve a customer, and for how long, will be determined on a case-by-case basis, and will depend on all of the facts and circumstances. We also determined that the existence of a notice provision in a contract would create a rebuttable presumption that the utility had no reasonable expectation of serving the customer beyond the specified period. We said that whether or not a contract contains an "evergreen" or other automatic renewal provision will be a factor to be considered in determining whether the presumption of no reasonable expectation is rebutted in a particular case.[724]

We also said that we would apply the reasonable expectation standard to retail-turned-wholesale customers. We explained that, before the Commission will permit a utility to recover stranded costs, the utility must demonstrate that it incurred such costs based on a reasonable expectation that the retail-turned-wholesale customer would continue to receive bundled retail service. Whether the state law awards exclusive service territories and imposes a mandatory obligation to serve would be among the factors to be considered in determining whether the reasonable expectation test is met in a particular case.[725]

We noted that Order No. 888 does not address who will bear the stranded costs caused by a departing generation customer if the Commission finds that the utility had no reasonable expectation of continuing to serve that customer. We indicated that we anticipate that, in such a case, a public utility will seek in subsequent requirements rate cases to have the costs reallocated among the remaining customers on its

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[724] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,831; *mimeo* at pp. 570-72.

[725] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,831; *mimeo* at p. 572. We indicated that the same procedures would apply to retail customers that obtain retail wheeling.

system. However, we stated that we were not prejudging that issue in the Rule.[726]

Rehearing Requests Opposing or Seeking Modification of the Reasonable Expectation Standard

APPA challenges the reasonable expectation standard as being too vague. It submits that the Commission has provided no guidance concerning application of the reasonable expectation standard, other than to state that it would decide the issue on a case-by-case basis. APPA objects that public utilities can exploit the uncertainty created by this standard, which will lead to costly and time-consuming litigation. IL Com supports replacing the reasonable expectation standard with a statutory, regulatory, contractual standard.

Several entities contend that there is no basis to conclude that the reasonable expectation test could ever be met. VT DPS and Valero submit that, since 1973, utilities have known that a refusal to wheel power could subject them to antitrust liability. They say that Order No. 888 ignores the breadth of NRC licensing conditions. LEPA similarly argues that the reasonable expectation standard could not be met where NRC license conditions required an explicit wheeling commitment and prohibited the utility from including in the wheeling cost any amount attributable to the loss of customers due to the wheeling. It objects that delaying a decision on stranded cost recovery in such cases holds the threat of possible stranded cost charges over the heads of bulk power purchasers and thereby chills their ability to seek competitive sellers.

TAPS asserts that there should be an irrefutable presumption that no stranded costs are due from customers with pre-existing transmission rights, including customers

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[726] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,831; *mimeo* at pp. 572-73.

who were the beneficiaries of NRC license conditions.[727] TAPS submits that there can be no legitimate "reasonable expectation" that such customers

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would continue to purchase power if the price was higher than the market price.

Occidental Chemical asks the Commission to clarify that a utility could have had no reasonable expectation of recovering stranded costs from customers who, prior to the issuance of the NOPR, had the opportunity to switch to an alternative electric supplier or had the option of self-generating, obtaining on-site third-party generation, or municipalizing. Occidental Chemical further argues that it defies commercial expectations to allow a utility to argue that if a contract is silent on the issue of renewal, the obligation to purchase does not expire with the termination of the contract. It submits that the Commission has not shown that it has the authority to force customers to extend purchase agreements against their will in violation of accepted commercial practice.

A number of entities submit that the Commission erred in failing to treat a notice of termination provision as conclusive evidence that the utility had no reasonable expectation of continued service.[728] Several object that the Commission has failed to explain why the presence of a notice provision does not conclusively demonstrate the lack of a reasonable expectation and *ipso facto* terminate the

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[727] AMP-Ohio submits that where transmission access and competition have existed to varying extents for decades, there should be an irrebuttable presumption of no reasonable expectation of continued service.

[728] *E.g.*, APPA, American Forest & Paper, Central Montana EC, NRECA, TDU Systems, Oglethorpe, IMPA, VT DPS, Valero, PA Munis.

obligation of the customer to purchase the product.[729] APPA objects that the Commission provided no evidence that it considered comments supporting making the presumption conclusive and that it found legally sufficient reasons to reject them.

PA Munis objects that the rebuttable presumption represents an unjustified departure from the Commission's traditional policy of enforcing the express terms of notice provisions without any inquiry into the reasonable expectations of the party, provided that the agreements were negotiated in good faith and approved by the Commission.[730] PA Munis contends that wholesale requirements customers negotiated notice provisions with the knowledge that the Commission would enforce the notice provisions according to their terms, including the specific length of the term.[731] PA Munis argues that it is arbitrary and capricious to provide utilities an opportunity to seek to amend these contracts.

Several entities submit that the rebuttable presumption invites litigation and promotes uncertainty for customers.[732] APPA objects that the Commission has failed to establish the showing that it would require to overcome the presumption.

Referring to the Commission's discussion of evergreen provisions, Central Montana EC argues that it is wrong to infer from the existence of an automatic renewal provision that the parties intended that the contract might run longer

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729 *E.g.*, APPA, NRECA, TDU Systems. *See also* VT DPS and Valero (by signing a contract with a termination date, the utility assumed the risk that the customer will elect to leave when the contract expires).

730 In support of its argument, PA Munis cites *Boston Edison Company*, 56 FPC 3414 (1976). *See also* American Forest & Paper.

731 *Citing Kentucky Utilities Company*, 23 FERC ¶61,317 (1983); *Philadelphia Electric Company and Susquehanna Electric Company*, 65 FERC ¶61,303 (1993).

732 *E.g.*, NRECA, IMPA, PA Munis.

than its initial term. Central Montana EC asserts that the presence of an evergreen provision infers simply that the parties agreed upon a mechanism to avoid the renegotiation of a power supply contract if, at the conclusion of its initial term, the parties were satisfied with the contract. It maintains that the parties' obligations are defined by the term and termination provisions of wholesale power contracts, and that the presence of a mechanism to avoid contract renegotiation does not alter those termination rights.

Commission Conclusion

We will reject the requests for rehearing of our decision to adopt a reasonable expectation standard to be applied on a case-by-case basis and to treat a notice provision in a contract as a rebuttable, not a conclusive, presumption of no reasonable expectation. Contrary to the claims of some entities, the Commission has explained the basis for its finding that utilities may have had an implicit obligation to serve their wholesale requirements customers and, therefore, that a utility should be given an opportunity to demonstrate that it incurred costs to provide

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service to a customer and that it had a reasonable expectation that it would continue to serve the customer beyond the contract termination date. The same factors that some petitioners contend establish the absence of a reasonable expectation of continued service may be offered as evidence to be considered in determining whether the reasonable expectation test is met in a particular case.

We believe that our decision to treat a notice of termination provision in a contract as creating a rebuttable presumption that the utility had no reasonable expectation of serving the customer beyond the period provided for in the notice provision is a reasonable one. It places evidentiary significance on the fact that a contract contains a notice of termination provision. Moreover, while it gives the utility an

opportunity, based on the facts and circumstances of a particular case, to rebut the presumption of no reasonable expectation, it firmly places the burden of establishing reasonable expectation on the utility. Although some entities support treating notice provisions as a conclusive presumption of no reasonable expectation, as discussed below, we decline to adopt such an inflexible approach. Nevertheless, as we indicated in Order No. 888, when a utility is seeking a contract amendment to permit stranded cost recovery based on expectations beyond the stated term of the contract, we believe that the utility has a heavy burden in demonstrating that the contract ought to be modified.[733]

Contrary to the position of PA Munis, the rebuttable presumption is fully consistent with the Commission's past treatment of notice provisions. For example, the *Kentucky Utilities Company* case cited by PA Munis supports the proposition that, until a customer *exercises* a notice of termination provision, the utility is under an implicit obligation to continue to serve and plan for the future needs of the customer.[734] Thus, the presence of a notice of termination provision in a contract (particularly one not yet exercised by the customer), in and of itself, may not necessarily support the conclusion that the utility could never prove that it reasonably expected to continue serving the customer beyond the notice period.[735]

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[733] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,665, 31,813-14; *mimeo* at p. 87, 522.

[734] *See Kentucky Utilities Company*, 23 FERC at pp. 61,679-80 ("Once it receives an effective notice of cancellation, Kentucky can stop planning for the future needs of that customer. . . . To be effective a notice of cancellation must contain a specification of the source of supply, the date on which the source of supply will be available, and an affidavit from the supplier that it will supply the customer on the date the contract ends.").

[735] *See Potomac Electric Power Company*, 43 FERC ¶61,189 (1988) (suspending a notice of termination for five months due to questions about the impact of the proposed cancellation on service reliability).

In response to APPA's objection that the Commission has failed to establish the showing that it would require to overcome the presumption, we note that the Commission cannot establish such a showing upfront because whether there is sufficient evidence to rebut the presumption of no reasonable expectation will depend on the facts of each case.

We appreciate the concerns expressed by some entities that the rebuttable presumption may increase the customer's uncertainty by inviting litigation. We have carefully weighed the pros and cons of treating a notice provision as a rebuttable presumption of no reasonable expectation versus the pros and cons of treating it as a conclusive presumption of no reasonable expectation. It is true, as some entities assert, that the rebuttable presumption approach presents the potential for litigation between the parties as to whether, in a particular case, the utility can rebut the presumption. The alternative would be to treat all contracts with notice of termination provisions as conclusive evidence that the utility could have had no reasonable expectation that it would continue to serve the customer beyond the specified notice period. While the latter approach presumably would reduce the number of cases in which the issue of a utility's reasonable expectation would have to be litigated, it would do so only by prohibiting a utility from ever demonstrating that, notwithstanding the existence of a notice provision, based on the facts of a particular case, the utility reasonably expected to continue serving the customer. While we do not prejudge the likelihood of a utility being able to rebut the presumption in a particular case, we believe that

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it would not be in the public interest for the Commission to absolutely preclude a utility from being able to make such a showing. On this basis, we conclude that treating a notice provision as a rebuttable, rather than a conclusive, presumption that the utility did not have a reasonable

expectation of continuing service to the customer is, on balance, the fairer and more equitable approach.

Central Montana EC asserts that it is wrong to infer from the existence of an automatic renewal provision that the parties intended that the contract might run longer than its initial term. However, our statement in Order No. 888 that the existence of an automatic renewal provision will be a factor to be considered in determining whether the presumption of no reasonable expectation is rebutted in a particular case makes no such inference. Whether the utility can rebut the presumption will depend on the facts of each case.

* * * *

APPENDIX F

***Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Notice of Proposed Rulemaking and Supplemental Notice of Proposed Rulemaking*, Notice of Proposed Rulemaking, [1988-1998 Proposed Regs.] F.E.R.C. Stats. & Regs. ¶ 32,514 (1995) (pertinent portion)**

APPENDIX F

[33,047]

[¶32,514]

60 F.R. 17662 (April 7, 1995)

18 CFR Part 385

[Docket Nos. RM95-8-000 and RM94-7-001]

Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities; Notice of Proposed Rulemaking and Supplemental Notice of Proposed Rulemaking

Issued March 29, 1995

AGENCY: Federal Energy Regulatory Commission.

ACTION: Notice of proposed rulemaking and supplemental notice of proposed rulemaking.

SUMMARY: The Federal Energy Regulatory Commission (Commission) is proposing to require that public utilities owning and/or controlling facilities used for the transmission of electric energy in interstate commerce have on file tariffs providing for nondiscriminatory open-access transmission services. The Commission is also proposing to permit public utilities and transmitting utilities to recover legitimate and verifiable stranded costs. The Commission's goal is to encourage lower electricity rates by structuring an orderly transition to competitive bulk power markets. The Commission is seeking public comment on its proposals.

DATES: Written comments must be received by the Commission by August 7, 1995. Reply comments must be received by the Commission by October 4, 1995.

FOR FURTHER INFORMATION CONTACT: David D. Withnell, Office of the General Counsel, Federal Energy Regulatory Commission, 825 North Capitol St., NE., Washington, DC 20426, telephone (202) 208-2063, (Docket No. RM95-8-000—legal issues).

Deborah B. Leahy, Office of the General Counsel, Federal Energy Regulatory Commission, 825 North Capitol St., NE., Washington, DC 20426, telephone (202) 208-2039, (Docket No. RM94-7-001—legal issues).

Michael A. Coleman, Office of Electric Power Regulation, Federal Energy Regulatory Commission, 825 North Capitol St., NE., Washington, DC 20426, telephone (202) 208-1236, (technical issues).

ADDRESSES: Send comments to: Office of the Secretary, Federal Energy Regulatory Commission, 825 North Capitol St., NE., Washington, DC 20426.

SUPPLEMENTARY INFORMATION: In addition to publishing the full text of this document in the *Federal Register*, the Commission also provides all interested persons an opportunity to inspect or copy the contents of this document during normal business hours in Room 3401, at 941 North Capitol St., NE., Washington, DC 20426.

The Commission Issuance Posting System (CIPS), an electronic bulletin board service, provides access to the texts of formal documents issued by the Commission. CIPS is available at no charge to the user and may be accessed using a personal computer with a modem by dialing (202) 208-1397. To access CIPS, set your communications software to 19200, 14400, 12000, 9600, 7200, 4800, 2400, 1200 or 300 bps, full duplex, no parity, 8 data bits and 1 stop bit. The full text of this document will be available on CIPS for 60 days from the date of issuance in ASCII and WordPerfect 5.1 format. After 60 days the document will be archived, but still accessible. The complete text on diskette in WordPerfect format may also be purchased from the

Commission's copy contractor, LaDorn Systems Corporation, also located in room 3104, 941 North Capitol Street, NE., Washington, DC 20426.

Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities

Docket No. RM95-8-000

Recovery of Stranded Costs by Public Utilities and Transmitting Utilities

[33,048]

RM94-7-001

Notice of Proposed Rulemaking and Supplemental Notice of Proposed Rulemaking

March 29, 1995

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I. Introduction

The electric power industry is today an industry in transition. In response to changes in the law, technology, and markets, competitive pressures are steadily building in the industry. Once the primary domain of large, vertically integrated utilities providing power at regulated rates, the industry now includes companies selling "unbundled" power at rates set by competitive markets. New generating facilities are being built at costs well below the average costs of some vertically integrated utilities. In this environment, more competition will mean lower rates for wholesale customers and, ultimately, for consumers.

The Commission's goal is to encourage lower electricity rates by structuring an orderly transition to competitive bulk power markets. Development of such markets is certain. The questions are when and how. Experience has shown that competitive pressures cannot be contained for long without serious economic distortions. Competition will, we are

confident, result in lower rates. But experience has also shown that a measured

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transition from regulated to competitive markets is absolutely essential.

Moving to competitive generation markets will fundamentally change long-standing regulatory relationships. Utilities have invested billions of dollars in order to meet their obligations. Those investments have been made under a "regulatory compact" whereby utilities—and their shareholders—expect to recover prudently incurred costs. With the advent of competition, even prudent investments may become stranded. Reliance on past contractual and regulatory practices must be recognized and past investments must be protected to assure an orderly, fair transition to competition.

The focus of our proposal today is to facilitate competitive wholesale electric power markets. The key to competitive bulk power markets is opening up transmission services. Transmission is the vital link between sellers and buyers. To achieve the benefits of robust, competitive bulk power markets, all wholesale buyers and sellers must have equal access to the transmission grid. Otherwise, efficient trades cannot take place and ratepayers will bear unnecessary costs. Thus, market power through control of transmission is the single greatest impediment to competition. Unquestionably, this market power is still being used today, or can be used, discriminatorily to block competition.

The Commission has an obligation to prevent unduly discriminatory practices in transmission access. In current circumstances, the absence of tariffs offering open access, non-discriminatory transmission services by each public utility impedes the transition to competitive markets greatly enough to be unduly discriminatory under section 206 of the Federal Power Act (FPA). Proceeding as we have in the

past, case-by-case, would delay unreasonably the transition to competitive markets. A patchwork of transmission systems—some open and some not—would also lead to unfair practices and inequitable burdens.

At the same time, while fulfilling our duty under section 206 of the FPA to cure undue discrimination, we see no need now to abrogate existing contractual relationships. Rather, we propose to provide a transition to a competitive generation industry that allows for the recovery of legitimate, prudent and verifiable costs lawfully incurred to serve customers under the terms of existing contracts. In the context of today's electric industry, the goals of increased competition and lower bulk power rates are best pursued through a structured transition rather than through abrogating all existing contracts.

In short, at this crossroad for the industry, it is critical to take the regulatory steps now to facilitate the transition to competitive bulk power markets in an orderly manner. The most important of these steps are to ensure non-discriminatory access to the transmission grid for all wholesale buyers and sellers of electric energy in interstate commerce, and to address the transition costs associated with open transmission access. The Commission will take these steps in a manner consistent with maintaining the reliability of the interstate transmission grid.

In this proceeding, the Commission pursuant to its authority under sections 205 and 206:

- proposes to require all public utilities owning or controlling facilities used for transmitting electric energy in interstate commerce to file open access transmission tariffs;

- proposes to require the utilities to take transmission service (including ancillary services) for their own wholesale sales and purchases of electric energy under the open access tariffs;

- issues a supplemental proposed rule to permit the recovery of legitimate and verifiable stranded costs associated with requiring open access tariffs; and

- proposes regulations to implement the filing of the open access tariffs and the initial rates under these tariffs.

The open access tariffs—to be offered to all sellers and buyers of electric energy sold at wholesale in interstate commerce—must offer wholesale transmission services (network and point-to-point), including ancillary services, on a nondiscriminatory

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basis to third parties.[1] In addition, the public utility must price separately all wholesale generation and transmission services (including ancillary services) and take wholesale transmission service under its own tariff, *i.e.*, "functionally unbundle" its wholesale generation and transmission services. The proposed rule does not mandate the corporate separation of generation, transmission, and distribution functions.

The proposed rule proposes *pro forma* tariffs for network and point-to-point services, defines non-discriminatory open access to include access to ancillary services, and requires that tariffs include a reciprocity provision requiring any user or agent of the user of the tariff that owns and/or controls transmission facilities to provide non-discriminatory access to the tariff provider.

To assure that the open access tariffs promote competition and do not operate in an unduly discriminatory manner, the proposed rule would require public utilities to provide all actual or potential transmission users the same access to

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[1] Throughout this NOPR this requirement will be referred to as the "non-discriminatory open access" requirement.

information as the public utility enjoys. The Commission is proposing to develop industry-wide real-time information networks in a separate Notice of Technical Conference that is being issued concurrently with this proposed rule.[2]

Not all transmitting utilities are public utilities subject to the Commission's jurisdiction under section 206 of the FPA.[3] The Commission cannot pursuant to section 206 require non-public utilities to file open access tariffs. Therefore, the proposed rule would encourage the broad application of section 211 as an additional means of achieving the goal in the Energy Policy Act of 1992 of promoting increased wholesale competition. Without broader application of section 211, wholesale bulk power market participants could be denied access to more competitive generation sources to the detriment of consumers.

We presently do not find it necessary to use our authority under section 206 of the FPA to reform public utilities' existing requirements contracts or any other contracts to eliminate undue discrimination or attain more competitive bulk power markets. However, we seek information about existing requirements contracts, including the remaining life

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2 Notice of Technical Conference and Request for Comments, Docket No. RM95-9-000.

3 Section 206 of the FPA applies to public utilities, whereas section 211 applies to transmitting utilities. A public utility is defined under section 201(e) of the FPA as "any person who owns or operates facilities subject to the jurisdiction of the Commission under this Part (other than facilities subject to such jurisdiction solely by reason of sections 210, 211, or 212)." A transmitting utility is defined under section 323 of the FPA as "any electric utility, qualifying cogeneration facility, qualifying small power production facility, or Federal power marketing agency which owns or operates electric power transmission facilities which are used for the sale of electric energy at wholesale." Not all transmitting utilities are public utilities. For instance, a municipally-owned electric utility that owns transmission facilities that are used for the sale of electric energy at wholesale is a transmitting utility, but is not a public utility.

and notice provision in each such contract, and whether it would be in the public interest to modify any existing contracts.

The Commission believes that the open access requirement will eliminate the transmission market power of public utilities by ensuring that all participants in wholesale power markets will have non-discriminatory open access to the transmission systems of public utilities. This market power has been the Commission's primary concern in recent years in analyzing requests for market-based generation rates. We therefore seek comments on the effect of industry-wide non-discriminatory open access on the Commission's criteria for authorizing power sales at market-based rates.

The Commission's market-rate criteria also have included other aspects of market power, such as generation dominance. In particular, we note the Commission's recent *KCP&L* decision, in which we dropped the generation dominance standard for market-based sales from *new* capacity.[4] This rule proposes to codify that decision, and seeks comment on whether the generation dominance standard should also be dropped for market-based sales from *existing* capacity.

[33,051]

In issuing this proposed rule, we are particularly concerned with its possible effect on stranded costs. It is important to couple our open access rule with a rule ensuring recovery of all legitimate transition costs, consistent with the guidelines established herein. Accordingly, we are making preliminary findings with respect to the Stranded Cost NOPR issued on June 29, 1994, seeking additional comments, and

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[4] *See Kansas City Power & Light Company*, 67 FERC ¶61,183 at p. 61,557 (1994) (*KCP&L*).

consolidating the Stranded Cost NOPR[5] with this proposed rule.

Because of the benefits associated with the transition to a competitive regime, it is important to have the open access tariffs in place as soon as possible. Thus, we propose a two-stage procedure to accomplish that goal. In Stage One, we would place generic open access tariffs in effect simultaneously on a date certain for every public utility that owns and/or controls transmission facilities[6] and would establish rates for each public utility based on the most current Form No. 1 data available. In Stage Two, utilities would be free to propose changes to the rates, terms, and conditions in the generic tariffs and customers and others would be free to file complaints seeking changes in the rates, terms, and conditions. However, Stage Two tariffs must contain at least the non-price tariff terms and conditions contained in the *pro forma* tariffs. Comments of all interested persons should be filed pursuant to the procedures set out below.

II. Public Reporting Burden

A. *Docket No. RM95-8-000*

The proposed rule specifies filing requirements to be followed by public utilities in making non-discriminatory open access tariff filings. The information collection requirements of the proposed rule are attributable to FERC-516 "Electric Rate Filings." The current total annual reporting burden for FERC-516 is 784,488 hours.

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5 *See Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Notice of Proposed Rulemaking*, 59 FR 35274 (July 11, 1994), *FERC Statutes and Regulations, Proposed Regulations* ¶32,507 (Stranded Costs NOPR).

6 Because power pools raise complex issues, we seek comments on how to implement the NOPR for power pools.

The proposed rule requires public utilities filing non-discriminatory open access tariffs to provide certain information to the Commission. The public reporting burden for the information collection requirements contained in the proposed rule is estimated to average 300 hours per response. This estimate includes time for reviewing the requirements of the Commission's regulations, searching existing data sources, gathering and maintaining the necessary data, completing and reviewing the collection of information, and filing the required information.

There are approximately 328 public utilities, including marketers and wholesale generation entities. The Commission estimates that approximately 137 of these utilities own or control facilities used for the transmission of electric energy in interstate commerce and will respond to the information collection. The respondents would be all public utilities required to file non-discriminatory open access tariffs. These are the public utilities that are also transmitting utilities and either file Form 715 or have it filed on their behalf. The information will be provided with each filing by a respondent. Accordingly, the public reporting burden is estimated to be 41,100 hours.

Send comments regarding this burden estimate or any other aspect of the Commission's collection of information, including suggestions for reducing this burden, to the Federal Energy Regulatory Commission, 941 North Capitol Street, N.E., Washington, DC 20426 [Attention: Michael Miller, Information Services Division, (202) 208-1415], and to the Office of Information and Regulatory Affairs of the Office of Management and Budget [Attention: Desk Officer for Federal Energy Regulatory Commission (202) 395-3087].

B. Docket No. RM94-7-001

The initially proposed rule would require public utilities seeking to recover stranded costs to provide certain information to the Commission. The Commission estimated

that the public reporting burden for the information collection requirements contained in the initially proposed rule would be 50 hours per response. The Commission also estimated that there

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would be ten respondents to the information collection annually.

Under the proposed rule contained in this supplemental notice of proposed rulemaking, the information that public utilities will be required to file is not substantially different from that required by the initially proposed rule. The Commission also believes that the average filing burden and frequency of filing will be approximately the same as under the initially proposed rule. Therefore, the Commission estimates that there will be no additional public filing burden associated with the proposed rule.

Send comments regarding this burden estimate or any other aspect of the Commission's collection of information, including suggestions for reducing this burden, to the Federal Energy Regulatory Commission, 941 North Capitol Street, N.E., Washington, DC 20426 [Attention: Michael Miller, Information Services Division, (202) 208-1415], and to the Office of Information and Regulatory Affairs of the Office of Management and Budget [Attention: Desk Officer for Federal Energy Regulatory Commission (202) 395-3087].

III. Discussion

A. *Summary of Authority and Findings*

The primary purposes of the Federal Power Act are to curb abusive practices by public utility companies and to protect consumers from excessive rates and charges. To achieve these ends, section 205 of the FPA requires that no public utility shall "make or grant any undue preference or advantage to any person or subject any person to any undue preference or disadvantage," with respect to the transmission

of electric energy in interstate commerce or the sale for resale of electric energy in interstate commerce.[7] Section 206 of the FPA authorizes the Commission to investigate and remedy unduly discriminatory or preferential rules, regulations, practices or contracts affecting public utility rates for transmission in interstate commerce or for sales for resale in interstate commerce.

The significant technological, structural, statutory, and regulatory changes over the past twenty years have affected the electric utility industry such that competitive bulk power markets are now emerging. This transition has expanded what the Commission must consider to be undue discrimination in the rates, terms, and conditions offered by public utilities. We find that utilities owning or controlling transmission facilities possess substantial market power; that, as profit maximizing firms, they have and will continue to exercise that market power in order to maintain and increase market share, and will thus deny their wholesale customers access to competitively priced electric generation; and that these unduly discriminatory practices will deny consumers the substantial benefits of lower electricity prices. We propose to prevent this discrimination by requiring all public utilities owning and/or controlling transmission facilities to offer non-discriminatory open access transmission services.

At the same time, we see no need now to abrogate existing contractual relationships. Instead, contracts should be permitted to run their course. Additionally, we believe that recovery of legitimate stranded costs is critical to the successful transition of the electric utility industry from a tightly regulated, cost-of-service utility industry to an open access, competitively priced power industry.

The requirement of open access coupled with the recovery of legitimate stranded costs furthers the

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[7] 16 U.S.C. §§ 824d(b) and 824(d).

Congressional purposes embodied in the Federal Power Act and the Energy Policy Act of 1992 of protecting consumers, ensuring reasonable rates, and encouraging competition.

Below, we set out the Commission's legal authority to require non-discriminatory open access, the relevant historical developments in the electric industry, and the need for regulatory reform.[8]

[33,053]

B. *Legal Authority*

1. Undue Discrimination/Anticompetitive Effects

The Commission has authority to remedy undue discrimination. That is clear. Some may argue that case law under the FPA limits our authority to order wheeling. We have carefully analyzed relevant cases examining our wheeling authority. We conclude that we have authority to require wheeling, or non-discriminatory open access, as a remedy for undue discrimination. Our analysis of the case law is set forth below.

In upholding the Commission's order requiring non-discriminatory open access in the natural gas industry, the court in *Associated Gas Distributors v. FERC* stated that the Natural Gas Act "fairly bristles" with concern for undue discrimination.[9] The same is true of the FPA. The Commission has a mandate under sections 205 and 206 of the FPA to ensure that, with respect to any transmission in interstate commerce or any sale of electric energy for resale

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[8] On February 16, 1995, the Coalition for a Competitive Electric Market filed a petition for a rulemaking on comparability. The Industrial Consumers and the Transmission Access Policy Study Group filed comments in support of the petition. The Commission will not separately notice the Coalition's petition, but seeks comment on that pleading, and the supporting pleadings, in this notice of proposed rulemaking.

[9] *Associated Gas Distributors v. FERC*, 824 F.2d 981, 998 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988) (*AGD*).

in interstate commerce by a public utility, no person is subject to any undue prejudice or disadvantage. We must determine whether any rule, regulation, practice or contract affecting rates for such transmission or sale for resale is unduly discriminatory or preferential, and must prevent those contracts and practices that do not meet this standard. As discussed below, *AGD* demonstrates that our remedial power is very broad and includes the ability to order industry-wide non-discriminatory open access as a remedy for undue discrimination. Moreover, the Commission's power under the FPA "clearly carries with it the responsibility to consider, in appropriate circumstances, the anticompetitive effects of regulated aspects of interstate utility operations pursuant to [FPA] §§202 and 203, and under like directives contained in §§205, 206, and 207."[10]

Based on the mandates of sections 205 and 206 of the FPA and the case law interpreting the Commission's authority over transmission in interstate commerce, we conclude that we have ample legal authority—indeed, a responsibility—under section 206 of the FPA to order the filing of non-discriminatory open access transmission tariffs if we find such order necessary as a remedy for undue discrimination or anticompetitive effects.[11] We discuss below the primary court decisions that touch on our wheeling authority under sections 205 and 206.

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[10] *See Gulf States Utilities Company v. FPC*, 411 U.S. 747, 758-59 (1973).

[11] In most situations, discrimination that precludes transmission access or gives inferior access will have at least potential anticompetitive effects because it limits access to generation markets and thereby limits competition in generation. Similarly, it is probable that any transmission provision that has anticompetitive effects would also be found to be unduly discriminatory or preferential because the anticompetitive provision would most likely favor the transmission owner vis-a-vis others.

The Commission's authority to order access as a remedy for undue discrimination under the NGA was upheld and discussed in detail in *AGD*. In *AGD*, the court upheld in relevant part the Commission's Order No. 436.[12] That order found the prevailing natural gas company practices to be "unduly discriminatory" within the meaning of section 5 of the NGA (the parallel to section 206 of the FPA) and held that if pipelines wanted blanket certification for their transportation services, they must commit to transport gas for others on a non-discriminatory basis; in other words, they must provide non-discriminatory open access.

In upholding the Commission's authority to require open access, the court first noted that the opponents' arguments against such authority were "uphill." The statute contains no language forbidding the Commission to impose common carrier status on pipelines, let alone forbidding the Commission to impose "a specific duty that happens to be a typical or even core component of such status." The court found that the legislative history cited by the opponents came nowhere near overcoming this statutory silence. Rather, the legislative history supported only the proposition that Congress itself declined to impose common

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carrier status.[13] Emphasizing Congress' deep concern with undue discrimination, the court found that the Commission had ample authority to "stamp out" such discrimination:

> The issue seems to come down to this: Although Congress explicitly gave the Commission the power and the duty to achieve one of the prime goals of

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12 Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol *FERC Statutes and Regulations, Regulation Preambles* ¶30,665 (1985).

13 *AGD, supra*, 824 F.2d at p. 997.

> common carriage regulation (the eradication of undue discrimination), the Commission's attempted exercise of that power is invalid because Congress in 1906 and 1914 and 1935 and 1938 itself refrained from affixing common carrier status directly onto the pipelines and from authorizing the Commission to do so. And this proposition is said to control no matter how sound the Order may be as a response to the facts before the Commission. We think this turns statutory construction upside down, letting the failure to grant a general power prevail over the affirmative grant of a specific one.[14]

The *AGD* court found that court decisions under the FPA did not support the view that the Commission's authority to "stamp out" undue discrimination is hamstrung by an inability to require non-discriminatory open access as a remedy. These decisions are discussed below.

One of the earliest cases on wheeling is *Otter Tail Power Company v. United States* (*Otter Tail*)[15] That case was a civil antitrust suit against an electric utility. The Court rejected the argument that the District Court could not order wheeling because to do so would conflict with the Federal Power Commission's (FPC) purported wheeling authority.[16] It pointed out that Congress had decided not to impose a common carrier obligation on the electric power industry and noted that the Commission was not at that time granted power to order wheeling. The *Otter Tail* case, however, did not address whether the Commission can require transmission in fulfillment of its duty to remedy undue discrimination.

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14 *Id.* at p. 998.

15 410, U.S. 366 (1974).

16 *Id.* at pp. 375-76.

Richmond Power & Light Company v. FERC (*Richmond*)[17] also did not involve requiring wheeling to remedy undue discrimination. In that case, the FPC, in reaction to the 1973 oil embargo, was attempting to reduce dependence on oil. The FPC requested that utilities with excess capacity wheel power to the New England Power Pool (NEPOOL). In response, several suppliers and transmission owners filed rate schedules with the FPC that provided for voluntary wheeling. Richmond Power & Light Company (Richmond) objected to these filings, claiming that they were unreasonable because they did not guarantee transmission access. The FPC refused to compel the utilities to wheel Richmond's power, stating that it did not have the authority to order a public utility to act as a common carrier.

The D.C. Circuit upheld the Commission. It acknowledged that Richmond's argument was persuasive in some respects, but stated that any conditions the Commission might impose could not contravene the FPA. The court examined the legislative history of the FPA and stated that "[i]f Congress had intended that utilities could inadvertently bootstrap themselves into common-carrier status by filing rates for voluntary service, it would not have bothered to reject mandatory wheeling. . . ."[18]

However, the D.C. Circuit in no way indicated that the Commission was foreclosed from ordering transmission as a remedy for undue discrimination. Richmond also had argued that the alleged refusal of the American Electric Power Company (AEP) and its affiliate, Indiana & Michigan Electric Company (Indiana), to wheel Richmond's excess energy was unlawful discrimination because AEP and Indiana wheeled higher-priced electricity from other AEP affiliates. The court acknowledged that Richmond's claim of

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17 574 F.2d 610 (D.C. Cir. 1978).

18 *Id.* at p. 620.

unlawful discrimination was theoretically valid, but found that Richmond had failed to prove its case. It noted that if Richmond had argued that the rates were unjustifiably discriminatory, or that Indiana's failure to use its transmission capability fully or to purchase less expensive electricity for wheeling resulted in unnecessarily high rates, a different case

[33,055]

would be before the court.[19] The case thus does not in any way limit the Commission's authority to remedy undue discrimination.

In *Central Iowa Power Cooperative v. FERC*,[20] the FPC[21] reviewed the terms of the Mid-Continent Area Power Pool (MAPP) Agreement under its section 205 and 206 authority. The agreement contained two membership limitations. First, the agreement established two classes of membership, with one class being entitled to more privileges than the other. Second, the agreement excluded non-generating distribution systems from pool services. The FPC found the first limitation on membership—the two-class system—to be unduly discriminatory and not reasonably related to MAPP's objectives. The FPC conditioned approval of the agreement under section 206 on the removal of the unduly discriminatory provision. The FPC found that the second limitation, the exclusion of non-generating distribution systems, was not anticompetitive and did not render the agreement inconsistent with the public interest.

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19 *Id.* at p. 623, nn.53 and 57.

20 606 F.2d 1156 (D.C. Cir. 1979).

21 While *Central Iowa* was pending, certain of the functions of the FPC were transferred to the FERC under the DOE Organization Act. Accordingly, the FERC was substituted for the FPC as the respondent in the case.

On appeal, the D.C. Circuit affirmed the FPC's decision. The court found that the FPC did have authority to order changes in the scope of the MAPP agreement, *if* the agreement was unjust, unreasonable, unduly discriminatory or preferential under section 206 of the FPA. The court stated:

> The Commission had authority, . . . under section 206 of the Act, . . . to order changes in the limited scope of the Agreement, including the addition of pool services, if, in the absence of such modifications, the Agreement presented "any rule, regulation, practice or contract [that was] unjust, unreasonable, unduly discriminatory or preferential."[22]

However, the court agreed with the FPC's conclusion that the limited scope of MAPP was not unjust, unreasonable, or unduly discriminatory. The court recognized that a pool was not invalid under section 206 merely because a more comprehensive arrangement was possible.

The D.C. Circuit upheld the Commission's refusal to eliminate the second limitation on membership by ordering MAPP participants to wheel to non-generating electric systems.[23] However, neither the Commission nor the court was presented with the argument that wheeling was necessary as a remedy for undue discrimination.

In *Florida Power & Light Company v. FERC* (*Florida*),[24] the Commission ordered Florida Power & Light Company (FP&L) to file a tariff setting forth FP&L's policy

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22 606 F.2d at p. 1168.

23 *Id.* at p. 1169; *see also Municipalities of Groton v. FERC*, 587 F.2d 1296 (D.C. Cir. 1978).

24 660 F.2d 668 (5th Cir. 1981), *cert. denied sub nom. Fort Pierce Utilities Authority v. FERC*, 459 U.S. 1156 (1983).

relating to the availability of transmission service.[25] FP&L objected to including such a policy statement in its tariff and argued that the filing of such a policy would convert FP&L into a common carrier by obligating it to offer service to all customers.[26] There was no finding that the action ordered was necessary to remedy undue discrimination.

The Fifth Circuit Court of Appeals agreed with FP&L that the mandatory filing of the policy statement would require FP&L to provide transmission service beyond its voluntary commitment because such a requirement would change

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its duties and liabilities.[27] The Commission order would impose common carrier status on FP&L, the court found.[28]

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[25] FP&L provided transmission service when four conditions were met: (1) the specific potential seller and buyer were contractually identified; (2) the magnitude, time and duration of the transaction were specified prior to the commencement of the transmission; (3) it could be determined that the transmission capacity would be available for the term of the contract; and (4) the rate was sufficient to cover FP&L's costs.

[26] All utilities requesting wheeling services, subject to availability, would be entitled to receive transmission service under the filed terms. Any changes to a filed rate must be filed with the Commission. This is the so-called "filed rate doctrine." *See Northwestern Public Service Company v. Montana-Dakota Utilities Company*, 181 F.2d 19, 22 (8th Cir. 1980), *aff'd*, 341 U.S. 246 (1951).

[27] Under the filed rate doctrine, a refusal to wheel would be unduly discriminatory under section 206 of the FPA. As the court acknowledged, a customer refused service could petition the Commission to find that FP&L's policy of availability was unduly discriminatory under section 206(a) of the FPA. The court said that in the absence of a tariff on file, a utility refused wheeling services would be unable to claim discrimination under section 206(a) of the FPA. 660 F.2d at p. 675 (expressing "serious doubts that such a petition would be successful in the absence of a tariff").

[28] *Id.* at p. 676.

The court noted that the Commission did not rely on a finding of anticompetitive behavior and therefore the court did not address the Commission's power to remedy antitrust violations.[29]

The *AGD* court explicitly rejected the claim that the above line of cases establishes that the Commission lacks authority to require non-discriminatory open access.[30] Opponents of the Commission's order argued in *AGD* that *Richmond* and *Florida*, *supra*, stand for the proposition that the Commission cannot indirectly do what it allegedly cannot do directly, that is, impose common carriage. The *AGD* court rejected these arguments, stating that the petitioners read the electric cases far too broadly:

> [n]either *Richmond* nor *Florida* comes anywhere near stating that the Commission is barred from imposing an open-access condition in all circumstances.[31]

The court noted that the *Florida* case had expressly left open the question of whether the Commission would be entitled to use an open access condition as a remedy for anticompetitive conduct, and that in *Richmond* the D.C. Circuit had said little more than that unwillingness to transmit for all could not be automatically deemed undue discrimination. The court also noted the *Central Iowa case*, *supra*, in which it had upheld a Commission order that found a power pooling agreement discriminatory on its face because the agreement gave one class of membership

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29 *Id.* at p. 678.

30 The *AGD* court did not address *New York State Electric & Gas Corporation v. FERC*, 638 F.2d 388 (2d Cir. 1980), *cert. denied*, 454 U.S. 821 (1981) (*NYSEG*), presumably because that case did not concern whether the Commission could order wheeling as a remedy for undue discrimination.

31 824 F.2d at p. 999.

privileged status over another. The court stated that the Central Iowa case "upholds the power of the Commission to subject approval of a set of voluntary transactions to a condition that providers open up the class of permissible users."[32] The court added that it refused to "turn statutory construction upside down" by letting Congress' failure to grant a general power of common carriage prevail over the affirmative grant of the specific power to eradicate undue discrimination.[33]

We conclude that *AGD*'s analysis of undue discrimination under sections 4 and 5 of the Natural Gas Act is equally applicable to an undue discrimination analysis under sections 205 and 206 of the FPA. The Commission and courts have long recognized that the NGA was patterned after the FPA and that the two statutes should be interpreted in the same manner.[34] Thus, we conclude that we have the authority to remedy undue discrimination and anticompetitive effects by requiring all public utilities that own and/or control transmission facilities to file non-discriminatory open access transmission tariffs.

2. Section 211 Services

In concluding that we must invoke our section 206 authority to remedy undue discrimination and anticompetitive actions in the electric industry, we have carefully considered the goals of Title VII of the Energy

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32 *Id.* at p. 999.

33 *Id.* at p. 1006.

34 *See, e.g., FPC v. Sierra Pacific Power Company*, 350 U.S. 348, 353 (1956); *Arkansas Louisiana Gas Company v. Hall*, 453 U.S. 571, 577 n.7 (1981); and *Kentucky Utilities Company v. FERC*, 760 F.2d 1321, 1325 n.6 (D.C. Cir. 1985). Section 206 of the FPA was recently revised and now differs from section 5 of the NGA, but not in a manner significant to our discussion here. *See* 16 U.S.C.§§ 824e(b) and (c).

Policy Act, and whether section 211, by itself, is sufficient to remedy undue discrimination in public utility

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transmission services.[35] Title VII of the Energy Policy Act, which amended section 211 of the FPA, reflects the intent of Congress to encourage competitive wholesale electric markets. Section 211 provides a means for wholesale power sellers and buyers to obtain transmission services necessary to compete in, or to reach, competitive markets, and is a valuable tool to encourage competitive markets. However, as discussed below, reliance on section 211 alone in some circumstances can result in the perpetuation of, rather than the elimination of, undue discrimination and anticompetitive effects.

First, there are inherent delays in the procedures for obtaining service under section 211. However, for competitive reasons, many transactions must be negotiated relatively quickly. Many competitive opportunities will be lost by the time the Commission can issue a final order under section 211. While we interpret section 211 to permit a customer or group of customers to seek broad tariff-like arrangements,[36] case-by-case section 211 proceedings are not a substitute for tariffs of general applicability that permit timely, non-discriminatory access on request.

Second, discrimination is inherent in the current industry environment in which some customers and sellers are served by open access systems, and others have to rely on negotiated

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35 In amending section 211 Congress left unaltered the authorities and obligations of the Commission under sections 205 and 206 (similar to our authorities and obligations under sections 4 and 5 of the Natural Gas Act) to remedy undue discrimination.

36 *See El Paso Electric Company and Central and South West Services, Inc.*, 68 FERC ¶61,181 at p. 61,916 (1994) (*CSW*), *reh'g pending*.

bilateral arrangements or the mandatory section 211 process. The end result is discrimination in the ability to obtain transmission services, as well as in the quality and prices of the services. This national patchwork of open and closed transmission systems cannot be cured effectively through section 211.

The Commission believes that its actions under sections 205 and 206 will complement the section 211 procedures in achieving the goals of creating more competitive bulk power markets and lower rates for consumers, while avoiding many years of costly and unnecessary litigation. Section 211 will be particularly important for developing non-discriminatory access by non-public utilities.

C. Background

1. Structure of the Electric Industry to Enactment of Federal Power Act

The Federal Power Act was enacted in an age of mostly self-sufficient, vertically integrated electric utilities, in which generation, transmission, and distribution facilities were owned by a single entity and sold as part of a bundled service (delivered electric energy) to wholesale and retail customers. Most electric utilities built their own power plants and transmission systems, entered into interconnection and coordination arrangements with neighboring utilities, and entered into long-term contracts to make wholesale requirements sales (bundled sales of generation and transmission) to municipal, cooperative, and other investor-owned utilities (IOUs) connected to each utility's transmission system. Each system covered limited service areas. This structure of separate systems arose naturally due primarily to the cost and technological limitations on the distance over which electricity could be transmitted.

Through much of the 1960s, utilities were able to avoid price increases, but still achieve increased profits, because of substantial increases in scale economies, technological

improvements, and only moderate increases in input prices.[37] Thus, there was no pressure on regulatory commissions to use regulation to affect the structure of the industry.[38]

2. Significant Changes in the Electric Industry

In the late 1960s and throughout the 1970s, a number of significant events occurred in the electric industry that changed the perceptions of utilities and

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began a shift to a more competitive marketplace for wholesale power.[39] This was the beginning of periods of rapid inflation, higher nominal interest rates, and higher electricity rates.[40] During this time, consumers became concerned about higher electricity rates and questioned any price increases filed by utilities.[41]

During this same time frame, the construction of nuclear and other capital-intensive baseload facilities—actively encouraged by federal and some state governments—contributed to the continuing cost increases and uncertainties

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37 Paul L. Joskow, Inflation and Environmental Concern: Structural Change in the Process of Public Utility Regulation, 17 J. Law & Econ. 291, 312 (1974); *see also* Charles F. Phillips, Jr., *The Regulation of Public Utilities* 11 (1988).

38 See *Joskow*, *supra* note 37, at p. 312; *also* Phillips, *supra* note 37, at p. 12.

39 *See Joskow*, *supra* note 37, at p. 312; see *also* Phillips, *supra* note 37, at p. 12-13

40 *See Joskow*, *supra* note 37, at p. 312-13; *see also* Phillips, *supra* note 37, at p. 13. The Arab oil embargo resulted in significantly higher oil prices through the 1970s. *See Richard J. Pierce, Jr.*, The Regulatory Treatment of Mistakes in Retrospect: Canceled Plants and Excess Capacity, 132 U. Pa. L. Rev. 497, 501 (1984).

41 *See Joskow*, *supra* note 37, at p. 313; *see also* Phillips, *supra* note 37, at p. 13.

in the industry.[42] These investments were made based on the assumptions that there would be steady increases in the demand for electricity and continued large increases in the price of oil.[43] However, due to conservation and economic downturns, the expected demand increases did not materialize. Load growth virtually disappeared in some areas, and many utilities unexpectedly found themselves with excess capacity.[44] In addition, by the 1980s, the oil cartel collapsed, with a resulting glut of low- priced oil.[45] At the same time, inflation substantially increased the costs of these large baseload generating plants.[46] Surging interest rates further increased the cost of the capital needed to finance and capitalize these projects and completion schedules were significantly extended by, in part, more stringent safety and environmental requirements.[47]

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[42] *See generally Jersey Central Power & Light Company v. FERC*, 810 F.2d 1168, 1171 (D.C. Cir. 1987).

[43] *Id.*

[44] *See Pierce, supra* note 40, at p. 503. By 1983, the Department of Energy had estimated that the sunk costs for canceled nuclear plants alone amounted to $10 billion, *Id.* at p. 498.

[45] *Id.*

[46] *See Bernard S. Black & Richard J. Pierce Jr.*, The Choice Between Markets and Central Planning in Regulating the U.S. Electricity Industry, 93 Col. L. Rev. 1339, 1346 (1993) ("Actual costs of nuclear power plants vastly exceeded estimated, sometimes by as much as 1000%.").

[47] *See Phillips, supra* note 37, at p. 13. Fossil fuel-fired plants became subject to increased regulation as a result of the Clean Air Act of 1970, and its 1977 amendments, 42 U.S.C. § 7401-7642. In 1971, nuclear plant licensing became subject to the environmental impact statement requirements of the National Environmental Policy Act of 1969. 42 U.S.C. § 4332. Following the 1979 accident at the Three Mile Island nuclear plant, nuclear plants also became subject to additional safety regulations, resulting in higher costs. *See* Energy Information Administration, *The Changing Structure of the Electric Power Industry 1970-1991* (March 1993) 35. Between 1976 and 1980, most states and many localities instituted laws governing power plant siting.

As a result, expensive large baseload plants came onto the market or were in the process of being constructed, for which there was little or no demand. Accordingly, between 1970 and 1985, average residential electricity prices more than tripled in nominal terms, and increased by 25% after adjusting for general inflation.[48] Moreover, average electricity prices for industrial customers more than quadrupled in nominal terms over the same period and increased 86% after adjusting for inflation.[49] The rapidly increasing rates for electric power during this period, together with the opportunities provided by the Public Utility Regulatory Policies Act of 1978 (PURPA) (discussed *infra*), also prompted some industrial customers to bypass utilities by constructing their own generation facilities. This further exacerbated rate increases for remaining customers—primarily residential and commercial customers.

Consumers responded to these "rate shocks" by exerting pressure on regulatory bodies to investigate the prudence of management decisions to build generating plants, especially when construction resulted in cost overruns, excess capacity, or both. Between 1985 and 1992, writeoffs

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of nuclear power plants totalled $22.4 billion.[50] These writeoffs significantly reduced the earnings of the affected utilities.[51] Delays in obtaining rate increases to reflect the effects of inflation further reduced investor returns. Thus, many utilities became reluctant to commit capital to long-

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[48] Based on retail prices reported in Energy Information Administration (EIA), Monthly Energy Review, January 1995, Table 9.9 (Prices adjusted for inflation using the GDP Deflator (1987 = 100)).

[49] *Id.*

[50] *See Black & Pierce, supra* note 46, at p. 1346 (These writeoffs were "about 17% of the book value of total 1992 utility investment.").

[51] *Id.*

term construction decisions involving large scale generating plants.[52]

In addition to economic changes in the industry, significant technological changes in both generation and transmission have occurred since 1935. Through the 1960s, bigger was cheaper in the generation sector and the industry was able to capitalize on economies of scale to produce power at lower per-unit costs from larger and larger plants.[53] As a result, large utility companies that could finance and manage construction projects of larger scale had a price advantage over smaller utility companies and customers who might otherwise have considered building their own generating units. Scale economies encouraged power generation by large vertically-integrated utility companies that also transmitted and distributed power. Beginning in the 1970s, however, additional economies of scale in generation were no longer being achieved.[54] A significant factor was that larger generation units were found to need relatively greater maintenance and experience longer downtimes.[55] The electric industry faced the situation "where the price of

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[52] *Id.* ("The high perceived risk of future disallowances reversed utilities' incentives to overinvest, and made utilities extremely reluctant to build new power plants.").

[53] *See* Preston Michie, Billing Credits for Conservation, Renewable, and Other Electric Power Resources: an Alternative to Marginal-Cost-Based Power Rates in the Pacific Northwest, 13 Environmental Law 963, 964-65 (1983).

[54] *Id.* at p. 965.

[55] Energy Information Administration, *The Changing Structure of the Electric Power Industry 1970-1991* (March 1993) 37 ("As larger units were constructed, however, utilities discovered that downtime was as much as 5 times greater for units larger than 600 megawatts than for units in the 100-megawatt range.").

each incremental unit of electric power exceeded the average cost."[56] Bigger was no longer better.

Further dictating against larger generation units were advances in technologies that allowed scale economies to be exploited by smaller size units, thereby allowing smaller new plants to be brought on line at costs below those of the large plants of the 1970s and earlier. Such new technologies include combined cycle units and conventional steam units that use circulating fluidized bed boilers.[57]

The combined cycle generating plants generally use natural gas as their primary fuel. This technology has been made possible by the development of more efficient gas turbines, shorter construction lead times, lower capital costs, increased reliability, and relatively minimal environmental impacts.[58] Similarly, the circulating fluidized bed combustion boilers, fueled by coal and other conventional fuels, provide a more efficient and less polluting resource.

Today, "the optimum size [of generation plants] has shifted from [more than 500 MW] (10-year lead time) to smaller units (one-year lead time) [in the 50- to 150-MW range]."[59] Indeed, smaller and more efficient gas-fired combined-cycle generation facilities can produce power on

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56 *Id.*; *see also* George A. Perrault, Downsizing Generation: Utility Plans for the 1990s, Pub. Util. Fort. 15-16 (Sept. 27, 1990) ("The large base-load generating units that form the backbone of utility systems are almost totally absent from capacity plans for the 1990s.").

57 "From 1982 through 1991, the average capacity of fluidized-bed units increased rapidly to 72 megawatts for 4 units in 1991. The average capacity for the 19 units planned to begin operating in 1992 through 1995 increases to 83 megawatts." Energy Information Administration, *The Changing Structure of the Electric Power Industry 1970-1991* (March 1993) 38.

58 *See* Charles E. Bayless, Less is More: Why Gas Turbines Will Transform Electric Utilities, Pub. Util. Fort. (Dec. 1, 1994) 21.

59 *Id.* at p. 24.

the grid at a cost between 3 and 5 cents per kWh.[60] This is significantly less than

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the costs for large plants constructed and installed by utilities over the last decade, which were typically in the range of 4 to 7 cents per kWh for coal plants and 9 to 15 cents for nuclear plants.[61]

Significant changes have also occurred in the transmission sector of the industry. Technological advances in transmission have made possible the economic transmission of electric power over long distances at higher voltages.[62] This has made it technically feasible for utilities with lower cost generation sources to reach previously isolated systems where customers had been captive to higher cost generation. In addition, the nature and magnitude of coordination transactions[63] have changed dramatically since

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60 FERC staff calculations based in part on combined-cycle plant cost data reported in 1993 FERC Form No. 1 for a sample of units placed in service during 1990-92. Costs vary with regional fuel and construction costs, among other reasons.

61 Coal and Nuclear plant cost data reported in 1993 FERC Form No. 1 and the EIA report, *Electric Plant Cost and Power Production Expenses 1991*, 1993 DOE/EIA-0455(91), for plants placed in service during 1986-93; *see also* The 1994 Electric Executives' Forum, Bakke (President and CEO of the AES Corporation), Pub. Util. Fort. (June 1, 1994) 45 ("New generation can be built at about 3 cents per kilowatt-hour (U.S. average). Old generation costs about twice that....").

62 See Black & Pierce, *supra* note 46, at p. 1345 (In the late 1960s and 1970s, improved transmission efficiency and development of regional transmission networks "made it possible to build power plants up to 1000 miles from power users.").

63 Coordination transactions are voluntary sales or exchanges of specialized electricity services that allow buyers to realize cost savings or reliability gains that are not attainable if they rely solely on their own resources. For sellers, these transactions provide opportunities to earn

enactment of the FPA, allowing increased coordinated operations and reduced reserve margins. Substantial amounts of electricity now move between regions, as well as between utilities in the same region. Physically isolated systems have become a thing of the past.

3. The Public Utility Regulatory Policies Act and the Growth of Competition

In enacting PURPA,[64] Congress recognized that the rising costs and decreasing efficiencies of utility-owned generating facilities were increasing rates and harming the economy as a whole.[65] To lessen dependence on expensive foreign oil, avoid repetition of the 1977 natural gas shortage, and control consumer costs, Congress sought to encourage electric utilities to conserve oil and natural gas.[66] In particular, Congress sanctioned the development of alternative generation sources designated as "qualifying facilities" (QFs) as a means of reducing the demand for traditional fossil fuels.[67] PURPA required utilities to purchase power from

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additional revenue, and to lower customer rates, from capacity that is temporarily excess to native load capacity requirements.

64 Pub. L. No. 95-617, 92 Stat. 3117 (codified in U.S.C. sections 15, 16, 26, 30, 42 and 43).

65 *See* generally *FERC v. Mississippi*, 456 U.S. 742, 745-46 (1982).

66 The Power Plant and Industrial Fuel Use Act of 1978. Pub. L. No. 95-617, 92 Stat. 3117 (codified in U.S.C. sections 15, 16, 26, 30, 42, and 43).

67 QFs include certain cogenerators and small power producers. PURPA also added sections 210, 211 and 212 to the FPA, providing the Commission with authority to approve applications for interconnections and, in limited circumstances, wheeling. However, under section 211, as enacted in PURPA, the Commission could approve an application for wheeling only if it found, *inter alia*, that the order "would reasonably preserve existing competitive relationships." Because of this and other limitations in sections 211 and 212 as originally enacted, the provision was virtually ineffective. Only one section 211 order was ever issued pursuant to the original provision, and it was pursuant to a settlement.

QFs at a price not to exceed the utility's avoided costs and to sell backup power to QFs.[68]

PURPA specifically set forth limitations on who, and what, could qualify as QFs. In addition to technological and size criteria, PURPA set limits on who could own QFs.[69] Notwithstanding these limitations,

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QFs proliferated. In 1989, there were 576 QF facilities. By 1993, there were more than 1,200 such facilities.[70] For the same time period, installed QF capacity increased from 27,429 megawatts to 47,774 megawatts.[71] The rapid expansion and performance of the QF industry demonstrated that traditional, vertically integrated public utilities need not be the only sources of reliable power.

During this period, the profile of generation investment began to change, and a market for non-traditional power

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See Public Service Company of Oklahoma, 38 FERC 61,050 (1987). As discussed *infra*, section 211 was subsequently revised by the Energy Policy Act of 1992.

[68] 456 U.S. at p. 750. Congress recognized that encouragement was needed in part because utilities had been reluctant to purchase electric power from, and sell power to, nonutility generators. *Id.* at p. 750-51.

[69] For example, PURPA provided that a cogeneration facility or small power production facility could not be owned by a person primarily engaged in the generation or sale of electric power (other than from cogeneration or small power production facilities). *See* 16 U.S.C. §§ 796(17) and (18).

[70] Energy Information Administration, *Electric Power Annual 1993* (December 1994) 124 (Table 77).

[71] *Id.* EIA data for 1989 through 1991 was for facilities of 5 megawatts or more and for 1992 and 1993 was for facilities of 1 megawatt or more. A comparison with Table 74 on page 121 for the years 1992 and 1993 reveals that this mixing of data bases is likely of minimal effect.

supply beyond the purchases required by PURPA began to emerge. QFs were limited to cogenerators and small power producers.[72] However, other non-traditional power producers who could not meet the QF criteria began to build new capacity to compete in bulk power markets, without such PURPA benefits as the mandatory purchase requirements. These producers, known as independent power producers (IPPs), were predominantly single-asset generation companies that did not own any transmission or distribution facilities. While traditional utilities were generally reluctant at that time to invest in new generating facilities under cost of service regulation, utilities increasingly became interested in participating in this new generation sector. They organized affiliated power producers (APPs), with assets not included in utility rate base, and sought to sell power in their own service territories and the territories of other utilities. At the same time, power marketers arose. These entities—owning no transmission or generation—buy and sell power.[73]

There were two major impediments to the development of IPPs and APPs. First, the ownership restrictions of the

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[72] Generally, the law has imposed an 80 MW cap on small power producers. A limited exception enacted in 1990 permitted small power facilities that could exceed 80 MW and still qualify as QFs under PURPA. This exception was limited to certain solar, wind, waste, and geothermal small power production facilities and only covered applications for certification of facilities as qualifying small power production facilities that were submitted no later than December 31, 1994 and for which construction commences no later than December 31, 1999. *See* Solar, Wind, Waste, and Geothermal Power Production Incentives Act of 1990, Pub. L. No. 101-575, 104 Stat. 2834 (1990), *amended*, Pub. L. No. 102-46, 105 Stat. 249 (1991).

[73] The first power marketer in the electric industry was Citizens Energy Corporation. *See Citizens Energy Corporation*, 35 FERC ¶61,198 (1986). Power marketers take title to electric energy. Power brokers, on the other hand, do not take title and are limited to a matchmaking role.

Public Utility Holding Company Act (PUHCA)[74] severely inhibited these new entities from entering the generation business.[75] Second, these entities needed transmission service in order to compete in electricity markets.

While the Commission had no authority to remove PUHCA restrictions,[76] it encouraged the development of IPPs and APPs, as well as emerging power marketers, by authorizing market-based rates for their power sales on a case-by-case basis and by encouraging more widely available transmission access. From 1989 through 1993, facilities owned by IPPs and other non-traditional generators (other than QFs) increased from 249 to 634 and their installed capacity increased from 9,216 megawatts to 13,004 megawatts.[77] Indeed, "[i]n 1992, for the first time, generating capacity added by independent producers exceeded capacity added by utilities."[78]

Market-based rates helped to develop competitive bulk power markets. A generating utility allowed to sell its power at

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market-based rates could move more quickly to take advantage of short-term or even long-term market

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74 15 U.S.C. §§ 79 *et. seq.*

75 As discussed *infra*, Congress eventually provided a means to avoid the PUHCA restrictions by creating exempt wholesale generators (EWGs) in the Energy Policy Act.

76 The industry was successful to some extent in developing ownership structures that permitted such investment. *See, e.g., Commonwealth Atlantic Limited Partnership*, 51 FERC ¶61,368 at p. 62,240 and n.20 (1990).

77 Energy Information Administration, *Electric Power Annual 1993* (December 1994) 124 (Table 77).

78 Black & Pierce, *supra* note 46, at p. 1349 n. 25.

opportunities than those laboring under traditional cost-of-service tariffs, which entail procedural delays in achieving tariff approvals and changes.

In approving these market-based rates, the Commission required, *inter alia*, that the seller and any of its affiliates lack market power or mitigate any market power that they may have possessed.[79] The major concern of the Commission was whether the seller or its affiliates could limit competition and thereby drive up prices. A key inquiry became whether the seller or its affiliates owned or controlled transmission facilities in the relevant service area and therefore, by denying access or imposing discriminatory terms or conditions on transmission service, could foreclose other generators from competing.[80] As we have previously explained:

> The most likely route to market power in today's electric utility industry lies through ownership or control of transmission facilities. Usually, the source of market power is dominant or exclusive *ownership* of the facilities. However, market power also may be gained without ownership. Contracts can confer the same rights of control. Entities with contractual control over transmission facilities can withhold supply and extract monopoly prices just as effectively as those who control facilities through ownership.[81]

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79 *See, e.g., Ocean State Power*, 44 FERC ¶61,261 (1988); *Commonwealth Atlantic Limited Partnership*, 51 FERC ¶61,368 (1990); *Citizens Power & Light Company*, 48 FERC ¶61,210 (1989); *Orange and Rockland Utilities, Inc.* 42 FERC ¶61,012 (1988); *Doswell Limited Partnership*, 50 FERC ¶61,251 (1990) (Doswell); and *Dartmouth Power Associates Limited Partnership*, 53 FERC ¶61,117 (1990).

80 *See, e.g., Doswell*, 50 FERC at p. 61,757.

81 *Citizens Power & Light Corporation*, 48 FERC ¶61,210 at p. 61,777 (1989) (emphasis in original); *see also Utah Power & Light Company*,

As entry into wholesale power generation markets increased, the ability of customers to gain access to the transmission services necessary to reach competing suppliers became increasingly important.[82] In addition, beginning in the late 1980s, public utilities seeking Commission approval of mergers or consolidations under section 203 of the FPA or Commission authorization for blanket approval of market-based rates for generation services under section 205 of the FPA, filed "open access" transmission tariffs of general applicability to mitigate their market power to meet Commission conditions.[83] The Commission applied its

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PacifiCorp and PC/UP&L Merging Corporation, 45 FERC ¶61,095 at p. 61,287-89 (1988), *order on reh'g*, 47 FERC ¶61,209, *order on reh'g*, 48 FERC ¶61,035 (1989), *remanded in part sub nom. Environmental Action, Inc. v. FERC*, 939 F.2d 1057 (D.C. Cir. 1991), *order on remand*, 57 FERC ¶61,363 (1991).

[82] In earlier years, a few customers were able to obtain access as a result of litigation, beginning with the Supreme Court's decision in *Otter Tail*, 410 U.S. 366 (1973). Additionally, some customers gained access by virtue of Nuclear Regulatory Commission license conditions and voluntary preference power transmission arrangements associated with federal power marketing agencies. *See, e.g., Consumers Power Company*, 6 NRC 887, 1036-44 (1977) and *The Toledo Edison Company and Cleveland Electric Illuminating Company*, 10 NRC 265, 327-34 (1979). *See Florida Municipal Power Agency v. Florida Power Power and Light Company*, 839 F. Supp. 1563 (M.D. Fla. 1993). *See also* Electricity Transmission: Realities, Theory and Policy Alternatives, The Transmission Task Force Report to the Commission, October 1989, 197.

[83] *See, e.g., Public Service Company of Colorado*, 59 FERC ¶1,311 (1992), *reh'g denied*, 62 FERC ¶61,013 (1993); *Utah Power & Light Company, et al.*, Opinion No. 318, 45 FERC ¶61,095 (1988), *order on reh'g*, Opinion No. 318-A, 47 FERC ¶61,209 (1989), *orders on reh'g*, Opinion No. 318-B, 48 FERC ¶61,035 (1989), *aff'd in relevant part sub nom. Environmental Action Inc. v. FERC*, 939 F.2d 1057 (D.C. Cir. 1991); *Northeast Utilities Service Company (Public Service Company of New Hampshire)*, Opinion No. 364-A, 58 FERC ¶61,070, *reh'g denied*, Opinion No. 364-B, 59 FERC ¶61,042, *order granting motion to vacate and dismissing request for rehearing*, 59 FERC ¶61,089 (1992), *affirmed in relevant part sub nom. Northeast Utilities Service Company v. FERC*, 993 F.2d 937 (1st Cir. 1993).

market rate analysis to IOUs, as well as IPPs, APPs, and marketers, and allowed IOUs to sell at market-based rates only if they opened their transmission systems to competitors.[84] The Commission also approved

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proposed mergers on the condition that the merging companies remedy anticompetitive effects potentially caused by the merger by filing "open access" tariffs. These early "open access" tariffs required only that the companies provide point-to-point transmission services, which is a much narrower requirement than that being proposed in this rule. However, only 21 public utilities have any form of open access transmission; the vast majority of IOUs still do not provide any form of "open access" transmission over their transmission systems.

The economic and technological changes in the transmission and generation sectors helped give impetus to the many new entrants in the generating markets who could sell electric energy profitably with smaller scale technology at a lower price than many utilities selling from their existing generation facilities at rates reflecting cost. However, the advantages of these technological advances can be achieved only if more efficient generating plants can obtain access to the regional transmission grids. Because the traditional vertically integrated utilities still favor their own generation if and when they provide transmission access to third parties, barriers continue to exist to cheaper, more efficient generation sources.

4. The Energy Policy Act

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[84] *See, e.g., Public Service of Indiana, Inc.* 51 FERC ¶61,367 (1990), *reh'g denied*, 52 FERC ¶61,260 (1990), *appeal dismissed sub nom. Northern Indiana Public Service Company v. FERC*, 954 F.2d 736 (D.C. Cir. 1992).

In response to the competitive developments following PURPA, and the fact that PUHCA and lack of transmission access[85] remained major barriers to new generators, Congress enacted Title VII of the Energy Policy Act of 1992 (Energy Policy Act).[86] A goal of the Energy Policy Act was to promote greater competition in bulk power markets by encouraging new generation entrants, known as exempt wholesale generators (EWGs), and by expanding the Commission's authority under sections 211 and 212 of the FPA to approve applications for transmission services.[87]

An EWG is defined as

> any person determined by the Federal Energy Regulatory Commission to be engaged directly, or indirectly through one or more affiliates as defined in [PUHCA] section 2(a)(11)(B), and exclusively in the business of owning or operating, or both owning and operating, all or part of one or more eligible facilities and selling electric energy at wholesale.[88]

If the Commission, upon an application, determines that a person is an EWG, that person will be exempt from PUHCA.[89] This provision removed a significant impediment to the development of IPPs and APPs by allowing them to

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85 *See infra* sections III.D.1 and 2.

86 Pub. L. No. 102-486, 106 Stat. 2776 (1992).

87 *See El Paso Electric Company and Central and South West Services, Inc.*, 68 FERC ¶61,181 at p. 61,914 (1994); *see also* Paul Kemezis, FERC's Competitive Muscle: The Comparability Standard, Electrical World 45 (Jan. 1995) ("In EPAct, Congress made it clear that the electric-power industry was to move toward a fully competitive market system, but left most of the implementation to FERC.")

88 15 U.S.C. § 79z-5a.

89 15 U.S.C. § 79z-5a(e).

develop projects as EWGs free from the strictures of PUHCA or the QF PURPA limitations.

While sections 211 and 212, as enacted by PURPA, were intended to provide greater access to the transmission grid, the limitations placed on these sections made them unusable in most circumstances.[90] However, as amended by the Energy Policy Act, these sections now give the Commission broader authority to order transmitting utilities to provide wholesale transmission services, upon application, to any electric utility, Federal power marketing agency, or any other person generating electric energy for sale for resale.

The Energy Policy Act also added section 213 to the FPA. Section 213(a) requires a transmitting utility that does not agree to provide wholesale transmission service in accordance with a good faith request to provide a written explanation of its proposed rates, terms, and conditions and its analysis of any physical or other constraints.[91] Section 213(b) required the Commission to enact a rule

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requiring transmitting utilities to submit annual information concerning potentially available transmission capacity and known constraints.[92]

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90 *See supra* note 67.

91 *See* Policy Statement Regarding Good Faith Requests for Transmission Services and Responses by Transmitting Utilities Under Sections 211(a) and 213(a) of the Federal Power Act, as Amended and Added by the Energy Policy Act of 1992, 58 FR 38964 (July 21, 1993), *FERC Statutes and Regulations, Regulations Preambles* ¶30,975 (1993) (Policy Statement Regarding Good Faith Requests for Transmission Services).

92 *See* Order No. 558, *New Reporting Requirements Implementing Section 213(b) of the Federal Power Act and Supporting Expanded Regulatory Responsibilities Under the Energy Policy Act of 1992, and Conforming and Other Changes to Form No. FERC-714, FERC Statutes and Regulations, Regulations Preambles* ¶30,980, *reh'g denied*, Order

5. The Present Competitive Environment.

Following the Energy Policy Act, the Commission established rules: (1) for certain generators to obtain EWG status and thus an exemption from PUHCA;[93] and (2) that required transmission information availability. The Commission also pursued a number of initiatives aimed at fostering the development of more competitive bulk power markets, including aggressive implementation of section 211, a new look at undue discrimination under the FPA, easing of market entry for sellers of generation from new facilities, and initiation of a number of industry-wide reforms. As stated by the Commission, in recognition of the Congressional goal in the Energy Policy Act of creating competitive bulk power markets:

> Our goal is to facilitate the development of competitively priced generation supply options, and to ensure that wholesale purchasers of electric energy can reach alternative power suppliers and vice versa.[94]

No. 558-A, 65 FERC ¶61,324 (1993), *regulations modified*, 59 FR 15333 (April 1, 1994), FERC *Statutes and Regulations, Regulations Preambles* ¶30,993.

93 *See* Order No. 550, *Filing Requirements and Ministerial Procedures for Persons Seeking Exempt Wholesale Generator Status*, 58 FR 8897 (February 18, 1993), FERC *Statutes and Regulations, Regulations Preambles* ¶30,964, *order on reh'g*, Order No. 550-A, 58 FR 21250 (April 20, 1993), *FERC Statutes and Regulations, Regulations Preambles* ¶30,969 (1993). As recognized by Congress and the Commission, availability of transmission information is critical in developing competitive markets. *See supra* notes 91 and 92. This opened the "black box" of information that previously was available only to transmission owners.

94 See Stranded Cost NOPR at p. 32,866; *American Electric Power Service Corporation*, 67 FERC ¶61,168, *clarified*, 67 FERC ¶61,317 (1994).

a. Use of Sections 211 and 212 to Obtain Transmission Access. The Commission has aggressively implemented sections 211 and 212 of the FPA, as amended by the Energy Policy Act, in order to promote competitive markets.[95] When wheeling requests under sections 211 and 212 have been made, the Commission has required wheeling in almost all of the requests it has processed. To date, the Commission has issued orders requiring wheeling in 9 of the 10 cases it has acted on, including 3 proposed orders and 6 final orders.[96]

As a general matter, section 211 has permitted some inroads to be made by customers in obtaining transmission service from public utilities that historically have declined to provide access to their systems, or have offered service only on a discriminatory basis. Under section 211, the Commission has granted requests for the broader type of service that most utilities historically have refused to provide—network service. Although transmission owners have provided limited amounts of unbundled point-to-point transmission service, third-party customers have not been able to obtain the flexibility of service that transmission owners enjoy.

In *Florida Municipal*, a section 211 case, the Commission ordered "network," rather than the narrower "point-to-point," service.[97] Network service permits

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95 16 U.S.C.A. §§824j-824k (West 1985 and Supp. 1994).

96 *See, e.g.* final orders issued in *City of Bedford*, 68 FERC ¶61,003 (1994), *reh'g pending*, *Florida Municipal Power Agency v. Florida Power & Light Company*,, 67 FERC ¶61,167 (1994), *reh'g pending Minnesota Municipal Power Agency*, 68 FERC ¶61,060 (1994); and *Tex-La Electric Cooperative of Texas*, 69 FERC ¶61,269 (1994); see also supra note 168.

97 *See Florida Municipal Power Agency v. Florida Power & Light Company*, 65 FERC ¶61,125, *reh'g dismissed*, 65 FERC ¶61,372 (1993), *final order*, 67 FERC ¶61,167 (1994), *reh'g pending*. The Commission has "characterized point-to-point service as involving designated points

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the applicant to fully integrate load and resources on an instantaneous basis in a manner similar to the transmission owner's integration of its own load and resources. At the same time, the Commission made the generic finding that the availability of transmission service will enhance competition in the market for power supplies and lead to lower costs for consumers. The Commission explained that as long as the transmitting utility is fully and fairly compensated and there is no unreasonable impairment of reliability, transmission service is in the public interest.[98]

As discussed in more detail above, however, our preliminary conclusion is that section 211 alone is not enough to eliminate undue discrimination. The significant time delays involved in filing an individual service request for bilateral service under section 211 places the customer at a severe disadvantage compared to the transmission owner and can result in discriminatory treatment in the use of the transmission system. It is an inadequate procedural substitute for readily available service under a filed non-discriminatory open access tariff. As the Commission noted in *Hermiston Generating Company*, "[t]he ability to spend time and resources litigating the rates, terms and conditions of transmission access is not equivalent to an enforceable

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of entry into and exit from the transmitting utility's system, with a designated amount of transfer capability at each point." *El Paso Electric Company v. Southwestern Public Service Company*, 68 FERC ¶61,182 at p. 61,926 n. 9 (1994) (*citing Entergy Services, Inc.*, 58 FERC ¶61,234 at p. 61,768 (1993), *reh'g dismissed*, 68 FERC ¶61,399 (1994)). Network service allows more flexibility by allowing a transmission customer to use the entire transmission network to provide generation service for specified resources and specified loads without having to pay multiple charges for each resource-load pairing.

98 *Florida Municipal*, 67 FERC at p. 61,477.

voluntary offer to provide comparable service under known rates, terms and conditions."[99]

b. Commission's Comparability Standard. In the Spring of 1994, the Commission began to address the problem of the disparity in transmission service that utilities provided to third parties in comparison to their own uses of the transmission system. In the seminal case in this area, *American Electric Power Service Corporation* (*AEP*), the company voluntarily proposed a tariff of general applicability that would offer firm, point-to-point transmission service for a minimum of one month.[100] The Commission accepted the proposed transmission tariff for filing and suspended its effectiveness for one day, subject to refund.[101] Rehearing requests challenged the Commission's summary approval of the restriction of service to point-to-point as being discriminatory and anticompetitive.[102] The rehearing requests argued that the tariff should be expanded to include network services such as those used by the transmission owner. On rehearing, the Commission announced a new standard for evaluating claims of undue discrimination.

The Commission found that a voluntarily offered, new open access transmission tariff that did not provide for services comparable to those that the transmission owner provided itself was unduly discriminatory and

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[99] 69 FERC ¶61,035 at p. 61,165 (1994), *reh'g pending, See also Southwest Regional Transmission Association*, 69 FERC ¶61,100 at p. 61,398 (1994) (*SWRTA*).

[100] 64 FERC ¶61,279 (1993), *reh'g granted*, 67 FERC ¶61,168, *clarified*, 67 FERC ¶61,317 (1994).

[101] The Commission explained that AEP could limit the service it was offering because it was "providing the service voluntarily under a tariff of general applicability." 64 FERC at p. 62,978.

[102] *AEP*, 67 FERC at p. 61,489.

anticompetitive.[103] In reaching that conclusion, the Commission broadened its undue discrimination analysis (which traditionally had focused on the rates, terms, and conditions faced by similarly situated third-party customers)

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to include a focus on the rates, terms, and conditions of a utility's own uses of the transmission system:

> [A]n open access tariff that is not unduly discriminatory or anticompetitive should offer third parties access on the same or comparable basis, and under the same or comparable terms and conditions, as the transmission provider's uses of its system.[104]

Refocusing the analysis was necessitated by the changing conditions in the electric utility industry, including the emergence of non-traditional suppliers and greater competition in bulk power markets. Because a transmission provider may use its system in different ways (*e.g.*, to integrate load and resources when serving retail native load, to make off-system sales or purchases, or to serve wholesale requirements customers), the Commission set for hearing the factual issues associated with identifying those uses, as well

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103 With respect to anticompetitive effects, the Commission explained that it has "adhered to the Supreme Court's determination that the Commission's 'important and broad regulatory power . . . carries with it the responsibility to consider, in appropriate circumstances, the anticompetitive effects of regulated aspects of interstate utility operations pursuant to §§ 202 and 203, and under like directives contained in §§ 205, 206 and 207.' *Gulf States Utilities Company v. FPC*, 411 U.S. 747, 758-59 (1972)." *Id.* at p. 61,490 (footnote omitted). The Commission reaffirmed that it would examine how best to fulfill this responsibility, as well as its responsibility to prevent undue discrimination, in light of the changing conditions in the electric utility industry. *Id.*

104 *Id.* at p. 61,490.

as any potential impediments or consequences to providing comparable services to third parties.[105]

After *AEP*, the Commission applied this comparability standard to a proposed open access transmission tariff that was filed by Kansas City Power & Light Company in support of a proposal to sell generation at market-based rates.[106] The Commission explained that, in light of *AEP*, the utility's proposed open access transmission tariff (which provided only for point-to-point service) did not adequately mitigate its transmission market power so as to justify allowing the requested market-based rates. KCP&L could charge market-based rates for sales only if it modified its proposed transmission tariff to reflect the *AEP* comparability standard.

Since then, the Commission has required comparable service in a variety of contexts, and has set for hearing the factual issues associated with comparable service. For example, the Commission found that market power can be adequately mitigated only if a merged company offers transmission services in accordance with the *AEP* comparability standard.[107] The Commission further held that, even if a merger does not result in an increase in market power, the merger would not be consistent with the public interest under section 203 of the FPA unless the merged company offers comparable transmission services, as defined in *AEP*.[108] The Commission therefore announced a transmission comparability requirement for all new mergers:

> Given the transition of the electric utility industry as a whole, we conclude that, absent other compelling

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105 *Id.* at p. 61,490-91.

106 *See Kansas City Power & Light Company*, 67 FERC ¶61,183 (1994), *reh'g pending*.

107 *E.g. CSW, supra* 68 FERC at p.61,914.

108 *Id.*

> public interest considerations, coordination in the public interest can best be secured only if merging utilities offer comparable transmission services.[109]

In *Heartland Energy Services, Inc.*,[110] the Commission applied its comparability standard to an affiliated electric power marketer seeking blanket authorization to sell electricity at market-based rates. The Commission explained that for all future cases involving blanket approval of market-based rates an offer of comparable transmission services will be required before the Commission will be able to find that transmission market power has been adequately mitigated. In the context of an affiliated power marketer, this means that all of its affiliated utilities must have a comparable transmission tariff on file.[111]

The Commission also denied a request by a company affiliated with a transmission-owning utility seeking permission to sell power at market-based rates to a particular customer. The denial was without prejudice to refiling such a request in a new section 205 proceeding, but only after the

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109 *Id.* at p. 915 (footnote omitted).

110 68 FERC ¶61,223 (1994).

111 *Id.* at p. 62,060. In *InterCoast Power Marketing Company*, 68 FERC ¶61,248, *clarified*, 68 FERC ¶61,324 (1994), the Commission rejected an affiliated marketer's proposal to sell at market rates without its affiliate utility offering comparable transmission services. The Commission stated that the only way to ensure that InterCoast does not have transmission market power is to require its affiliated public utility to offer comparable transmission services. *See also LG&E Power Marketing Inc.*, 68 FERC ¶61,247 at p. 62,120-21 (1994). The Commission added that this is consistent with encouraging competitive bulk power markets as envisioned by the Energy Policy Act of 1992. Id. at p. 62,132.

affiliated transmission-owning utility filed a comparable transmission service tariff.[112]

The Commission added that it will require comparability in any situation in which a seller seeking market-based rates is affiliated with an owner or controller of transmission facilities.[113]

The Commission has also stated that "it will henceforth apply the transmission comparability standard announced in the *AEP* case to all transmitting utility members of an RTG."[114] The Commission further declared that comparable services must be provided through "open access" tariffs rather than only on a contract-by-contract basis:

> [T]ariffs are essential to the provision of comparable services. Tariffs set out the services that are available and the terms and conditions under which those services will be made available....[In contrast], a negotiation process creates uncertainty and imposes on customers delay and other transaction costs that the transmitting utility members of an RTG do not incur when using the transmission for

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112 *See Hermiston Generating Company*, 69 FERC ¶61,035 at p. 61,164 (1994), *reh'g pending*. The Commission subsequently accepted the rates on a cost basis. See Letter Order dated November 10, 1994.

113 *Id.* at p. 61,165.

114 *See SWRTA*, 69 FERC at p. 61,397; see also PacifiCorp, the California Municipal Utilities Association, and the Independent Energy Producers (on behalf of Western Regional Transmission Association), 69 FERC ¶ 61,099 *order on reh'g*, 69 FERC ¶ 61,352 (1994) (*WRTA*). An RTG is a regional transmission group. It is defined as "a voluntary organization of transmission owners, transmission users, and other entities interested in coordinating transmission planning (and expansion), operation and use on a regional (and inter-regional)." Policy Statement Regarding Regional Transmission Groups, 58 FR 41626 (August 5, 1993), *FERC Statutes and Regulations, Regulations Preambles* ¶ 30,976 at p. 30,870 n.4 (RTG Policy Statement).

> their own benefit. Moreover, the ability to execute separate transmission agreements with different but similarly situated customers is the ability to unduly discriminate among them. A tariff ensures against such discrimination in the RTG.[115]

Thus, the Commission required the RTGs to amend their bylaws to commit all transmitting utility members to offer comparable transmission services to other RTG members pursuant to a transmission tariff or tariffs.

Most recently, the Commission has set for hearing whether transmission tariffs meet the *AEP* comparability standard in Commonwealth Edison Company,[116] Wisconsin Electric Power Company,[117] and Wisconsin Public Service Corporation.[118] In all three cases, the company agreed in principle to provide comparable service, but issues arose as to what constitutes such service.

c. Lack of Market Power in New Generation. In *KCP&L*, discussed in the prior section, the Commission continued to recognize that transmission remains a natural monopoly. However, it found that, in light of the industry and statutory changes that now allow ease of market entry, no wholesale seller of generation has market power in generation from *new* facilities.[119] In particular, the Commission explained that it had previously noted in *Entergy Services, Inc.* that there was significant evidence that non-traditional power project developers, including

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115 *SWRTA*, 69 FERC at p. 61,398.

116 70 FERC ¶ 61,204 (1995).

117 70 FERC ¶ 61,074 (1995).

118 70 FERC ¶ 61,075 (1995).

119 *KCP&L*, 67 FERC ¶ 61,183 (1994).

qualifying facilities and independent power projects, are becoming viable competitors in long-run markets.[120]

The Commission further explained that since *Entergy*, Congress had enacted the Energy Policy Act, which had lowered barriers to the entry of new suppliers by creating a new class of power suppliers—EWGs—that are exempt from the provisions of PUHCA.[121] The Commission concluded that, in considering market-based rate proposals for generation sales, it need only focus on market power in transmission,

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generation market power in short-run markets, and other barriers to entry.[122]

d. Further Commission Action Addressing a More Competitive Electric Industry. To address the fact that the electric industry is becoming more competitive, and to remove barriers that might inhibit a more competitive industry, the Commission has initiated a number of additional proceedings: (1) Stranded Cost Notice of Proposed Rulemaking,[123] (2) Transmission Pricing Policy Statement,[124]

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[120] *Id.* at p. 61,557 (citing *Entergy Services, Inc.*, 58 FERC ¶ 61,234 at p. 61,756 and nn.63 and 65 (*Entergy*)).

[121] *Id.* The Commission added that "after examining generation dominance in many different cases over the years, we have yet to find an instance of generation dominance in long-run bulk power markets." *Id.*

[122] *Id.* In *KCP&L*, the Commission declined to dismiss the possibility of market power in generation associated with sales out of *existing* capacity. As noted, however, we here seek comments on whether, and if so under what conditions, to drop the generation dominance standard in short-run markets, *i.e.*, for sales from existing capacity.

[123] *See supra* note 5.

[124] *See Inquiry Concerning the Commission's Pricing Policy for Transmission Services Provided by Public Utilities Under the Federal Power Act*, 59 FR 50331 (November 3, 1994), *FERC Statutes and*

(3) Pooling Notice of Inquiry,[125] and (4) Regional Transmission Group (RTG) Policy Statement.[126]

In the Stranded Cost NOPR the Commission recognized that the trend toward greater transmission access and the transition to a fully competitive bulk power market could cause some utilities to incur stranded costs as wholesale requirements customers (or retail customers) use their supplier's transmission to purchase power elsewhere. As the Commission noted, a utility may have built facilities or entered into long-term fuel or purchased power supply contracts with the reasonable expectation that its customers would renew their contracts and would pay their share of long-term investments and other incurred costs. If the customer obtains another power supplier, the utility may have stranded costs. If the utility cannot locate an alternative buyer or somehow mitigate the stranded costs, the Commission explained that "the costs must be recovered from either the departing customer or the remaining customers or borne by the utility's shareholders."[127] Accordingly, the Commission proposed to establish provisions concerning the recovery of wholesale and retail stranded costs by public utilities and transmitting utilities.[128]

Regulations, Regulations Preambles ¶ 31,005 (Transmission Pricing Policy Statement).

[125] *See Inquiry Concerning Alternative Power Pooling Institutions Under the Federal Power Act*, 59 FR 54851 (October 26, 1994), *FERC Statutes and Regulations*, Notices ¶ 35,529 (1995) (Pooling Notice of Inquiry).

[126] *See Policy Statement Regarding Regional Transmission Groups*, 58 FR 41626 (August 5, 1993); *FERC Statutes and Regulations, Regulations Preambles* ¶ 30,976 (RTG Policy Statement).

[127] Stranded Cost NOPR at p. 32,864.

[128] The Commission herein is making preliminary findings on stranded costs and issuing a supplemental Stranded Cost NOPR, seeking

In the Transmission Pricing Policy Statement, the Commission announced a new policy providing greater flexibility in the pricing of transmission services provided by public utilities and transmitting utilities. The Commission traditionally had allowed only postage-stamp, contract-path pricing.[129] Under the new policy, it will permit a variety of proposals, including distance sensitive and flow-based pricing,[130] which may be more suitable for competitive wholesale power markets. The Commission explained that this "[g]reater pricing flexibility is appropriate in light of the significant competitive

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changes occurring in wholesale generation markets, and in light of our expanded wheeling authority under the Energy Policy Act of 1992."[131] However, the Commission explained that any new transmission pricing proposal must meet the Commission's *AEP* comparability standard. The Commis-

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comments on the impact of our proposed open access NOPR on stranded costs.

[129] Most transmission contracts set a single price for energy flow over a utility's transmission system. This single-price policy is called "postage stamp" pricing because the rate does not depend on how far the power moves within a company's transmission system. If power flows through several companies, traditional industry practice is to specify that power flows along a "contract path" consisting of the transmission-owning utilities between the ultimate receipt and delivery points. *See infra* discussion of *Indiana Michigan Power Company*, 64 FERC ¶ 61,184.

[130] Unlike with postage stamp pricing, with distance-sensitive pricing the cost of moving power through a company depends on how far the power moves within the company. In contrast to contract path pricing, flow-based pricing establishes a price based on the costs of the various parallel paths actually used when the power flows. Because flow-based pricing can account for all parallel paths used by the transaction, all transmission owners with facilities on any of the parallel paths would be compensated for the transaction.

[131] Transmission Pricing Policy Statement at p. 31,136.

sion further explained that comparability of service applies to price as well as to terms and conditions.[132]

The Commission issued the Pooling Notice of Inquiry to receive comments on traditional power pools and on alternative power pooling institutions that are being explored in today's more competitive environment. The Commission expressed concern that [g]iven the ongoing changes in the competitive environment of the electric utility industry—in particular, the potential for substantially increased access to transmission—we must consider whether we are appropriately balancing our dual objectives of promoting coordination and competition.[133] Accordingly, the Commission explained that it wished to look at alternative power pooling institutions and to re-examine the role of more traditional power pools in today's environment of increased competition. In particular the Commission expressed its intent to ensure that its policies "are consistent with the development of a competitive bulk power market."[134]

In the RTG Policy Statement, the Commission announced a policy encouraging the development of RTGs. The Commission explained that a primary purpose of RTGs is to facilitate transmission access for potential users and voluntarily resolve disputes over such service. The Commission has recently conditionally approved the formation of two RTGs.[135] One of the conditions is that each RTG member must offer comparable transmission services by tariff to other RTG members.

In addition to the Commission's actions, a number of states have initiated proceedings concerning retail wheeling

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132 *Id.* at p. 31,142.

133 Pooling Notice of Inquiry at p. 35,715.

134 *Id.* at p. 35,714.

135 *See WRTA* and *SWRTA*, *supra*.

or proposed legislation for retail wheeling, that is, for ultimate consumers to choose their supplier of power.[136]

D. Need for Reform

The many changes discussed above have converged to create a situation in which new generating capacity can be built and operated at prices substantially lower than many utilities' embedded costs of generation. As discussed above, new generation facilities can produce power on the grid at a cost of 3 to 5 cents per kWh, yet the costs for large plants constructed and installed over the last decade were typically in the range of 4 to 7 cents per kWh for coal plants and 9 to 15 cents for nuclear plants. Non-traditional generators are taking advantage of this opportunity to compete. Indeed, the non-traditional generators' share of total U.S. electricity generation increased from 4 percent in 1985 to 10 percent in 1993.[137] Much of this increased share of generation is the result of competitive bidding for new generation resources that has occurred in 37 states. Since 1984, almost 4,000 projects, representing over 400,000 MW, have been offered in response to requests. Over 350 projects have been selected to supply 20,000 MW, and, of these, 126 are now

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[136] The Energy Information Administration recently indicated that at least nine states—California, Connecticut, Illinois, Michigan, Nevada, Ohio, Texas, Utah, and Vermont have proposals or legislation for retail wheeling. EIA, *Performance Issues for a Changing Electricity Power Industry*, January 1995 19-22. Most prominent among the recent state proposals are the California Public Utility Commission's "Blue Book" proposal (Order Instituting Rulemaking on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation, R. 94-04-031; Order Instituting Investigation on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation, I. 94-04-032) and the Michigan Public Service Commission's proposal (Interim Order on Experimental Retail Wheeling Program, Case No. U-10143/U-10176 (April 11, 1994)).

[137] Energy Information Administration, *Performance Issues for a Changing Electric Power Industry* (January 1995) 10 and (Figure 5).

online producing almost 7,800 MW of power.[138] In addition, the cost of utility-generated electricity differs widely across the major regions of

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the United States. Average utility rates range from 3 to 5 cents in the Northwest to 9 to 11 cents in California.[139] Electricity consumers are demanding access to lower cost supplies available in other regions of the United States, and access to the newer, lower cost generation resources. It is also important that the non-traditional generators of cheaper power be able to gain access to the transmission grid on a non-discriminatory open access basis.

The Commission's goal is to ensure that customers have the benefits of competitively priced generation. However, we must do so without abandoning our traditional obligation to ensure that utilities have a fair opportunity to recover prudently incurred costs and that they maintain power supply reliability. As well, the benefits of competition should not come at the expense of other customers. The Commission believes that requiring utilities to provide non-discriminatory open access transmission tariffs, while simultaneously resolving the extremely difficult issue of recovery of transition costs (discussed *infra*), is the key to reconciling these competing demands.

Non-discriminatory open access to transmission services is critical to the full development of competitive wholesale generation markets and the lower consumer prices achievable through such competition.[140] Transmitting utilities own the

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138 Current Competition, November 199_[?], Vol. 5, No. 8, at p. 8.

139 *See* map attached as Appendix A. This Appendix will not appear in the Federal Register.

140 As discussed above, only a minimal number of public utilities have any form of an "open access" tariff on file with the Commission and no

transportation system over which bulk power competition occurs and transmission service continues to be a natural monopoly. Denials of access (whether they are blatant or subtle), and the potential for future denials of access, require the Commission to revisit and reform its regulation of transmission in interstate commerce. Such action is required by the FPA's mandate that the Commission remedy undue discrimination.

1. Market Power

Unlike new generating capacity (*see* prior discussion of *KCP&L*), transmission remains and is expected to remain a natural monopoly. The Commission has addressed the natural monopoly character of transmission in the major cases summarized above and in the Commission's recent Transmission Pricing Policy Statement. The monopoly characteristic exists in part because entry into the transmission market is restricted or difficult.[141] In addition, as unit costs are less for larger lines and networks, transmission facilities still exhibit scale economies. From an economic, environmental, and aesthetic viewpoint, it is often better for a single owner (or group of owners) to build a single large transmission line rather than for many transmission owners to build smaller parallel lines on a non-coordinated basis.

Further, effective competition among owners of parallel transmission lines is unlikely, and often impossible, with existing practices and technology. For example, on an

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public utility has on file a non-discriminatory open access tariff as defined by this rule.

[141] An example of this is that, except in the limited case of licensed hydroelectric projects under Part I of the FPA, there is no Federal right of eminent domain available to assist in acquiring rights of way for new transmission lines. In addition, the regulatory requirements to build a transmission line vary from state to state. In all states, new transmission lines is getting harder.

alternating current (AC) electric system, electricity flows on parallel paths based on the impedance of each path. With two electric systems providing parallel contract paths, a share of the actual power flows would occur on each system according to the physical characteristics of the system. Thus, each of the two transmission service providers would have the incentive to underbid the other because the winner would receive all of the transmission revenues, but only incur a fraction of the costs. The loser, on the other hand, would incur the remaining costs, but would receive no revenues.

In today's electric industry, which is dominated by vertically integrated utilities, an owner or controller of transmission service can exclude generation competitors from the market, thereby favoring the transmission owner's own generation. This can occur through outright

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denial of transmission access, or, as is more likely, through access that is discriminatory as to rates, terms or conditions of service.[142] Thus, in the absence of non-discriminatory open access tariffs, the development of fully competitive bulk power markets cannot occur, and consumers will be deprived of the benefits that would be expected from such a competitive market.

2. Discriminatory Access

Some transmission-owning utilities have voluntarily begun to offer unbundled transmission tariff services to third-party suppliers and purchasers of wholesale power, though none have done so to the extent proposed by this proposed rule.[143] However, because utilities are naturally profit

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[142] *See, e.g.*, David W. Penn, A Municipal Perspective on Electric Transmission Access Questions, Pub. Util. Fort.18-19 (Feb. 6, 1986).

[143] The majority have offered only point-to-point services. However, a few utilities have sought to comply with the non-discrimination (comparability) standard announced in *AEP*. For example, Kansas City

maximizers and monopoly suppliers to their native load, the vast majority of transmission-owning utilities have not agreed to give up their market power voluntarily. Transmission-owning utilities have an incentive to deny access either by not filing *any* open access tariff or by filing a tariff that offers services inferior to those used by the transmission owner. This is particularly true for those utilities that emerged from the recent decades of technological and legal changes as high-cost generation companies. Open access transmission places their existing generation at risk because their wholesale customers may seek alternative lower price suppliers. It is in their self-interest to maintain and use market power to retain (or expand) market share for their existing generation facilities, at least until they can get their generation costs in line with current market prices. Because generating units are usually depreciated over a 30- to 50-year physical life, many high cost companies may attempt to exercise transmission market power for decades to preserve the value of past generation investments.

Unless all public utilities are required to provide non-discriminatory open access transmission, the ability to achieve full wholesale power competition, and resulting consumer benefits, will be jeopardized. If utilities are allowed to discriminate in favor of their own generation resources at the expense of providing access to others' lower cost generation resources by not providing open access on fair terms, the transmission grid will be a patchwork of open access transmission systems, systems with bilaterally negotiated arrangements, and systems with transmission ordered under section 211. Under such a patchwork of transmission systems, sellers will not have access to

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Power & Light Company (KCP&L) and Louisville Gas & Electric Company (LG&E) recently filed settlements to this effect. *KCP&L*, Docket No. ER94-1045 (settlement filed February 14, 1995) and *LG&E*, Docket No. ER94-1380 (settlement filed February 10, 1995).

transmission on an equal basis, and some sellers will benefit at the expense of others. The ultimate loser in such a regime is the consumer.

A patchwork of transmission systems will also result in inefficiencies across the Nation's transmission grids. Because of the physical properties of the transmission system, electric power moves over parallel transmission lines from generator to load, without regard to whether a line is part of a system providing open access or not.[144] However, today the industry develops transmission contracts as if power flowed along one series of lines belonging to specific owners, which is called the "contract path." Thus, transmission users will search for contract paths through open access systems to take advantage of the non-discriminatory open

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access tariffs. Because open access transmission tariffs include an obligation to expand when necessary to accommodate third-party requirements for service, transmitting companies offering open access services across

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[144] In *Indiana Michigan Power Company*, 64 FERC ¶ 61,184 (1993), the Commission explained loop flows and parallel power flows:

> In general, utilities transact with one another based on a contract path concept. For pricing purposes, parties assume that power flows are confined to a specified sequence of interconnected utilities that are located on a designated contract path. However, in reality power flows are rarely confined to a designated contract path. Rather, power flows over multiple parallel paths that may be owned by several utilities that are not on the contract path. The actual power flow is controlled by the laws of physics which cause power being transmitted from one utility to another to travel along multiple parallel paths and divide itself among those paths along the lines of least resistance. This parallel path flow is sometimes called "loop flow."

Id. at p. 62,545.

their systems could end up constructing a disproportionate share of new transmission facilities.

Expansion cannot be efficient under such a patchwork of open access transmission systems. Not only would this misallocate cost burdens to open access companies, but it is unlikely that the optimal transmission development will always be within their service territories. Expansion on closed systems, instead of open systems, may in some cases be the more efficient way to relieve constraints. Thus, a patchwork of open access systems will not result in the least cost expansion of the Nation's transmission grids. In addition, states with open access utilities may refuse to site new lines if their closed access neighbors are not doing their share.[145]

A discriminatory, patchwork system also works against pricing parallel power flows on a sensible regional basis. The formation of effective regional transmission groups, which the Commission strongly encourages, would be fostered if all utilities in a region offered non-discriminatory open access.[146] In fact, optimal cooperative regional action would involve all transmission systems in the region offering non-discriminatory open access to all wholesale customers.

A transmission-owning utility may deny access to third parties not only to avoid losing its own generation sales, but also to maintain other trading gains. For example, a company can buy low cost power for its own use from a

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[145] The Commission partially addressed this concern by allowing reciprocity provisions in open access transmission tariffs. *See, e.g., Southwestern Electric Power Company and Public Service Company of Oklahoma*, 65 FERC ¶ 61,212 at p. 61,981-82 (1993), *order on reh'g.* 66 FERC ¶ 61,099 (1994).

[146] While the Commission has conditioned its approval of RTGs to achieve this same result, the formation of RTGs is voluntary. By contrast, compliance with the final rules adopted in this proceeding will be required.

neighbor at a low price if other buyers cannot reach that neighbor to bid up the price. Furthermore, if it does not need the energy, it can market that power by buying low and selling high.

In the past, transmission-owning utilities have discriminated against others seeking transmission access. Transmission-owning utilities have denied access by outright refusals to deal. While such actions tend to be rare, likely because transmission owners fear they may trigger antitrust action,[147] they have occurred.[148] More often, however, discrimination is likely to be manifested more subtly and indirectly.[149] One such way would be for transmission owners to adopt a negotiating strategy that involves a sequence of informational and other requirements over a protracted period of time. By the time all of the requirements are finally satisfied, the window for the customer's trade

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147 *See, e.g.*, Penn, *supra* note 142, at p. 18

148 Otter Tail Power Company refused to wheel power for the village of Elbow Lake. The Supreme Court ultimately ruled against Otter Tail on antitrust grounds. *Otter Tail Power Company*, 410 U.S. 366 (1974). The Commission has also found that Utah Power & Light Company consistently refused to permit the wheeling of low-cost power across its system in order to use its strategically located bottleneck transmission system to extract monopoly prices. *Utah Power & Light Company, supra*, 45 FERC at p. 61,287 and n.137 (1988). O.

149 *See, e.g.*, Penn, *supra* note 142, at p. 18-19 (discussion of methods used to deny access). Penn also noted in his 1986 article that the American Public Power Association had conducted a survey of its members in which about 25% indicated a problem in securing transmission in effecting coordination services and about an equal amount had reported being denied transmission access in the recent past. Id. at p. 18. *See also Pacific Gas & Electric Company*, 51 FPC 1030, 1031-32, *reh'g denied*, 51 FPC 1543 (1974) (parties alleged that public utility proposed "a wholesale rate so high that its wholesale customers would be unable to compete with PG&E for large industrial retail loads" and entered into restrictive and anticompetitive contracts that strengthened public utility's monopoly).

opportunity has closed.[150] Another way of frustrating access is to substantially change the terms

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of negotiated agreements through protracted delay, including filings with regulatory agencies.[151]

Another way for transmission-owning utilities to frustrate access and competition is to allow access, but only on non-comparable or unsupportable terms and conditions that are inferior to the conditions under which the transmission owners themselves use or could use the transmission grid or on terms and conditions that have no operational or financial basis. Discrimination can be exercised this way in the following areas:

(1) *Network Service.* Network service allows a transmission customer to distribute a given amount of transmission usage between specified resources and specified loads without having to pay multiple charges for each resource-load pairing. Transmission owners can refuse to

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[150] Members of the Coalition for a Competitive Electricity Market alleged that they have encountered this strategy. Coalition Petition at p. 13, n. 19.

[151] An example of this tactic is evident in the history of Pacific Gas and Electric Company's (PG&E) attempt to avoid its commitments made to the California owners of the California-Oregon Transmission Project (COTP). The owners had originally planned the COTP to have its southern terminus at the Midway station with Southern California Edison. PG&E convinced them to terminate the project instead at PG&E's Tesla station and indicated that PG&E would provide transmission service the rest of the way south to Midway. PG&E promised this service in 1989 (in what came to be known as the South of Tesla Principles). PG&E spent the next four years filing substitute provisions for what it had promised in the Principles. See Pacific Gas and Electric Company, 65 FERC ¶ 61,312 at p. 62,428-30 and n.22, *remanded on other grounds, Pacific Gas & Electric Company v. FERC*, No. 94-70037 (9th Cir. June 23, 1994) (unpublished opinion), *order on remand*, 69 FERC ¶ 61,006 (1994).

provide service on these terms and instead insist on charges that are a function of the number of resource load pairings.[152] This can dramatically increase the cost of such service. Such treatment does not reflect the way transmission owners' costs are allocated to their own native load customers.

(2) *Pricing.* Transmission service can be made unattractive to third-party customers by pricing such service on a basis that is different from that used by the transmission owner and that results in higher rates. One example would be charging third-party customers distance-sensitive rates, while pricing all similar transmission bundled with power services on a postage stamp basis.[153]

(3) *Service Priority.* The priority of transmission service is a critical service factor. The transmission provider could disadvantage third-party transmission customers by making firm transmission service to them subordinate to the transmission utility's native load service.[154]

(4) *Scheduling and Balancing Provisions.* A transmission owner could hold transmission customers to unnecessarily long lead times to change power schedules. In some cases, scheduling could be required as much as a month

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[152] *See Pacific Gas and Electric Company*, 52 FERC ¶ 61,347 at p. 62,375-76 (1990) (proposal to charge a base demand and a flexibility adder for an integrating transmission service). PG&E eventually withdrew the proposal. 56 FERC ¶ 61, 373 at p. 62,429 (1991); *see also Florida Municipal Power Agency v. Florida Power & Light Company*, 65 FERC ¶ 61,125 (1993) (Federal Municipal Power Agency requested a section 211 order directing network service); *Tex-La Electric Cooperative of Texas*, 67 FERC ¶ 61,019 at p. 61,057 (1994) (Tex-La requested a section 211 order directing network service).

[153] *See* notes 129 and 130, *supra; see also Tex-La Electric Cooperative of Texas*, 69 FERC ¶ 61,269 at p. 62,034-35 (1994), in which the Commission found this practice to be unduly discriminatory.

[154] *See AEP*, 64 FERC at p. 62,971-72.

ahead of time.[155] This precludes transmission customers from using their service for short-term trading. Transmitting utilities may also insist that customers keep strict adherence to scheduling and balancing provisions by requiring them to get back on schedule quickly or face stiff penalties.[156] One example of a stiff penalty for failure to schedule sufficient power would be to assess shortfalls based on a partial requirements rate with an 11-month ratchet.[157] In contrast, transmitting utilities may have access to less costly balancing alternatives, such as substituting resources without notice or borrowing capacity from neighboring utilities and settling

[33,074]

the imbalance by returning energy in-kind within a much longer time period than allowed to customers.[158]

(5) *Use of Firm Transmission Capacity.* Transmission owners can unnecessarily restrict the firm transmission capacity made available to transmission customers. One way to restrict service would be to prohibit the customer from reassigning such capacity when it is not needed.[159] This restricts the customer's ability to manage the risk of long-term capacity purchases and to compete as a seller in the transmission service market. Another example would be that the transmission owner could restrict a customer's use of

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155 *Id.*

156 *See* Coalition Petition at p. 20-21.

157 *See Borough of Zelienople*, 70 FERC ¶ 61,073 at p. 61,184 (1995) (load exceeding schedule by 1 MW would be filled at a partial requirements rate using 60% demand ratchet for 11 months, *i.e.*, 1 MW times 60% times $9.30 per kW times 11, for a total of $61,380).

158 *See* Coalition Petition at p. 20-21.

159 *See, e.g., Pacific Gas and Electric Company*, 53 FERC ¶ 61,145 at p. 61,505 (1990) (utility proposed a reassignment prohibition on the use of Reserve Transmission Service available to the Sacramento Municipal Utility District under a proposed Interconnection Agreement).

transmission capacity by allowing sales only from the customer's generating resources that are temporarily in excess of actual load needs.[160] Transmission owners do not face these restrictions in their own use of transmission capacity.

(6) *Ancillary Services.* A transmitting utility may offer to a transmission customer ancillary services (*e.g.*, scheduling) that are inferior to the services it provides for itself. Transmission owners may be free to choose whether to supply some of these services to themselves or contract for them if available more cheaply elsewhere.[161] Third-party transmission customers do not always have this option on a comparable basis.

(7) *Creditworthiness and Security Deposits.* Customers are sometimes required to make onerous deposits in order to obtain service.[162]

(8) *Reciprocity Double Payments.* Transmission agreements often require reciprocity. Non-transmission owners could be required to contract with, and pay, third-party transmitting utilities to provide the required reciprocal service.[163] Transmission owners do not face such obstacles in using their own systems.

Finally, an additional way for transmission-owning utilities to frustrate access and competition is by granting

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160 *Id.* at p. 61,504-05 (utility proposed an export restriction on the use of Reserve Transmission Service available to the Sacramento Municipal Utility District under a proposed Interconnection Agreement).

161 *See* Coalition Petition at p. 28-29 and 32.

162 For example, it is reported that one customer was told that a $13 million line of credit would be required to ensure creditworthiness for a request of only one MW of transmission capacity for a coordination trade. See Coalition Petition at p. 30.

163 *See* Coalition Petition at p. 25; *see also AES Power, Inc.*, 69 FERC ¶ 61,345 at p. 62,295 and 62, 301 (1994) (AES).

each other superior rights and lower rates—compared to those available to non-transmission owning customers—in pools, interconnection agreements, and other protocols.[164] For example, pool-wide transmission service can be made available to members at rates less than those that each member would separately propose under traditional rate methods. This could disadvantage non-transmission owners if pool membership is restricted or if it requires excessive or vaguely stated transmission contributions that could be difficult to meet.[165]

Section 211 is not always a sufficient remedy for this discriminatory behavior. Third parties may seek non-discriminatory transmission under section 211, but they will not be able to compete if the sale or purchase opportunity is gone before a final order can be obtained under section 211. This could be the case in many situations because of the procedural requirements of sections 211 and 212.[166] Indeed, to date, the Commission has received eighteen section 211 transmission requests,[167-168] which it has tried to process

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expeditiously within the procedural constraints contained in sections 211 and 212. As to the seven requests that have received a final order, the average elapsed time from date of

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[164] *See* Coalition Petition at p. 13-14.

[165] *See Mid-Continent Area Power Pool*, 69 FERC ¶ 61,347 at p. 62, 308 (1994).

[166] For example, an applicant must make a request for transmission service to the transmitting utility at least 60 days before filing an application with the Commission for an order to provide transmission. The Commission must first issue a proposed order and allow the parties a reasonable time to negotiate agreeable terms and conditions before it can issue a final order. Moreover, a final order faces possible rehearing and a court appeal.

[167-168] One request was withdrawn.

filing to the date of a final order was 9 months. The remaining ten requests have been pending, on average, more than 6 months.

The following sets forth the status of the section 211 cases filed with the Commission:

Docket No.	Date of application	Status	Months pending
TX93-1 ..	01/19/93	Final Order-7/29/93	6
TX93-2 ..	06/18/93	Final Order-7/1/94	12
TX93-3 ..	06/30/93	Withdrew-9/10/93	2
TX93-4 ..	07/02/93	Final Order-5/11/94	10
TX94-1 ..	10/21/93	Final Order-7/6/94	9
TX94-2 ..	11/04/93	Pending[a]	16
TX94-3 ..	11/09/93	Final Order-7/13/94	8
TX94-4 ..	12/15/93	Final Order-12/1/94	11
TX94-5 ..	04/15/94	Final Order-3/23/95	11
TX94-6 ..	07/05/94	Pending	8
TX94-7 ..	07/15/94	Pending[a]	8
TX94-8 ..	08/05/94	Pending	7
TX94-9 ..	09/09/94	Pending[a]	6
TX94-10 ..	09/16/94	Pending	6
TX95-1 ..	10/11/94	Pending	5
TX95-2 ..	10/17/94	Pending	5
TX95-3 ..	01/19/95	Pending	2
TX95-4 ..	01/24/95	Pending	2

[a] A proposed order has been issued.

As the wholesale power markets become more competitive, delayed access becomes a matter of increasing concern. Not only have long-term purchases from non-traditional generators become more important, but short-term firm and non-firm power sales and purchases create significant profit or cost-saving opportunities for utilities, marketers, and their customers. As a result, market participants are exploring various ways to reduce their costs through trading. These include poolcos, changes to existing pools, short-term trading

[33,076]

systems, and futures contracts.[169] We do not see how such options will work unless all parties have non-discriminatory transmission access rights and hour-to-hour access without having to go through a regulatory proceeding for each trade.

In today's emerging competitive wholesale power markets, the practices of some transmission-owning utilities are unduly discriminatory and anticompetitive. These practices produce market distortions today, undermine the goal of the Energy Policy Act to create competitive bulk power markets, and will continue if this Commission does not take action. Most important, they can harm consumers by denying them the benefits of competitively priced power. We seek additional specific examples of such practices.

3. Analogies to the Natural Gas Industry

The electric industry today is analogous in many ways to the natural gas industry before the Commission issued Order Nos. 436 and 636.[170] Then, natural gas pipelines were primarily merchants offering a bundled sales service, which provided gas to customers at the city-gate from the pipelines' own system supplies. In addition, pipelines moved a

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[169] We note that NEPOOL and MAPP are currently exploring ways to modify their pool structures to accommodate competitive power markets. As noted in the Pooling Notice of Inquiry, *supra*, the poolco concept basically involves an independent entity that would control the operation of all transmission facilities and some or all generating facilities in a region. It would be open and would provide transmission service to all generators. Thus, the poolco would create a spot market for power in the region.

[170] Order No. 436, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, FERC Regulations Preambles* ¶ 30,665 (1985); Order 636, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 57 FR 13267 (April 16, 1992), FERC Statutes and Regulations ¶ 30,939 (Order No. 636), *appeal pending*.

relatively small amount of third-party gas under a separate transportation service. To meet their sales service obligations, pipelines purchased most of their system supply from third-party producers under long-term contracts. In the early 1980s, due to changing market conditions, the prices under many of these contracts ended up being higher than those available in the then evolving spot market. Because of the long-term contracts and the resulting higher cost gas, system supply gas tended to be more costly than gas that the customers could buy in the competitive spot market. At the same time, the transportation service bundled with a pipeline's sales service was usually superior to the transportation service third parties could obtain. Essentially, the pipeline would provide itself service that had much greater flexibility and often promised greater reliability than that available to third-party shippers. Pipelines had a considerable incentive to maintain this difference in transportation service quality to make their own, more expensive gas more attractive.

A similar situation exists today in the electric industry. Traditional public utilities deliver bundled service—generation and transmission—to most of their wholesale customers. They have monopoly control over transmission facilities and thus control access to their customers. The lack of non-discriminatory access to transmission services raises the same general concerns that were prevalent in the gas industry. Accordingly, unless similar regulatory measures are undertaken, the Commission expects the same type of discriminatory and anticompetitive behavior will continue in the electric industry as was present in the gas industry, because denying non-discriminatory access will continue to be in the economic self-interest of transmission monopolists, absent regulatory changes.[171]

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[171] *See AGD, supra*, 824 F.2d at p. 1008 ("Agencies do not need to conduct experiments in order to rely on the prediction that an unsupported stone will fall."). The ongoing discriminatory behavior by

In its regulation of interstate pipelines under the Natural Gas Act (NGA) the Commission initially addressed the problem of undue discrimination in Order No. 436, finding natural gas pipeline practices to be unduly discriminatory under

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the NGA[172] and effectuating "open access" transportation. The Commission in that order sought to make transportation available to third parties on a non-discriminatory basis. The Commission provided that, if a pipeline held itself out as a transporter of gas for others, it must provide that service to all shippers without discrimination. At the same time, the Commission allowed pipelines and their customers to retain the traditional bundled sales and transportation services under existing certificate authority.

As a result of Order No. 436, pipelines became primarily transporters of natural gas. However, in Order No. 636, the Commission noted that pipelines were still providing, albeit at a reduced level, a bundled, city gate, sales service in competition with third-party sales and transportation, and concluded that the competition was not occurring on an equal basis. The Commission also noted that pipelines' natural gas sales prices exceeded those of their competitors, much as electric utilities' embedded costs can exceed the cost of new generating capacity and excess generating capacity of others. In this regard, the Commission determined that the transportation service bundled with pipelines' sales service was superior to that made available to third parties and that pipelines and unregulated competitors were not selling the

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owners or controllers of transmission in the electric industry is detailed *supra*.

[172] In this regard, sections 4 and 5 of the NGA are virtually identical to sections 205 and 206 of the FPA.

same product.[173] Accordingly, in Order No. 636, the Commission found this behavior anticompetitive and required pipelines to "unbundle" their sales services from their transportation services and to provide open access transportation service that is equal in quality for all gas supplies whether purchased from the pipeline or some other supplier.[174]

Our experience in the gas area influences our decision that, at a minimum, functional unbundling of wholesale services is necessary in order to obtain non-discriminatory open access and to avoid anticompetitive behavior in wholesale electricity markets.

4. Coordination Rates

In finding a need for non-discriminatory open access transmission, the Commission has considered the structure of the coordination market, *i.e.*, the market for wholesale sales to a public utility's non-requirements customers. Utilities now engage in coordination trades primarily under rates no lower than the seller's variable cost and no higher than that variable cost plus 100% contribution to the fixed costs of the production unit used to price energy and the relevant transmission facilities. This rate flexibility allows the buyer and seller to negotiate a price reflecting the market at the time of the sale, including the number of buyers and sellers, the relative incremental and decremental variable costs, and the amount of savings attainable by transacting. Thus, while the seller's ceiling rate reflects some measure of fixed and variable costs, the actual transaction price is set, to a certain

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[173] Order No. 636 at p. 30,402. The Commission explained that pipelines were selling a regulated bundled sales and transportation service, but that their competitors were generally selling only the gas commodity. The Commission also recognized that pipelines were at a competitive disadvantage due to their certificate and contractual obligations to their firm sales customers. *Id.* at p. 30,403.

[174] Order No. 636 at p. 30,393-94.

extent, by the marketplace. This marketplace, however, may be skewed by the general lack of transmission access, and the resulting price may be considerably above prices in a fully competitive market.

Some utilities transact under a split-savings rate that generally sets the price halfway between the seller's incremental variable cost and the buyer's decremental variable cost. Here again, price is a function of the alternatives reachable through the transmission grid at the time of the transaction. This rate form is primarily used today to distribute the savings derived from the central dispatch of power pools on an after-the-fact basis.

The Commission believes that unless the participants in coordination markets mitigate their transmission market power, market-driven prices for coordination trades may no longer be just and reasonable. Thus, our preliminary conclusion is that current coordination pricing is no longer justified in the absence of a tariff offer of non-discriminatory open access transmission services by the seller (owning or controlling transmission) in a

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coordination transaction.[175] The Commission's past practice of allowing such pricing for coordination trades appears to be inconsistent with emerging competitive markets unless those who benefit from such trading offer access to other, lower-priced trading opportunities. We seek comments on this issue.

E. The Proposed Regulations

The goals of the proposed regulations are two-fold: (1) to facilitate the development of competitive wholesale bulk power markets by ensuring that wholesale purchasers of

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[175] As discussed *infra*, sellers must also meet the Commission's other requirements to obtain market-based rates.

electric energy and wholesale sellers of electricity can reach each other by eliminating anticompetitive practices and undue discrimination in transmission services; and (2) to address the transition costs associated with the development of competitive wholesale markets. This section addresses the elimination of undue discrimination. Transition costs are addressed below in Section F.

Non-discriminatory open access transmission is critical to the ability of sellers to compete on a fair basis and the ability of purchasers to reach the lowest priced generation options. Thus far, the Commission has developed an open access comparability requirement on a case-by-case basis. We have directed our administrative law judges, to whom the various cases have been referred, to examine the factual circumstances surrounding a utility's use of its own system *vis-a-vis* the type of service provided to third parties. Nonetheless, it has now become evident to us that it is necessary for the Commission to define the parameters of a non-discriminatory open access tariff much more precisely.

Until now, we have been applying the new standard of what constitutes undue discrimination only to new voluntary tariff filings. We now no longer believe it is appropriate to apply this standard so narrowly; therefore, we are proposing to require all public utilities to offer non-discriminatory open access services in accord with the proposed rule and the attached tariffs. This broad application is consistent with our determination that undue discrimination by jurisdictional public utilities must be prevented or remedied. It is also consistent with our desire to bring further efficiencies to the provision of electric service by encouraging competitive bulk power markets.

1. Non-discriminatory Open Access Tariff Requirement

Transmission owners can discriminate by restricting access to, or restricting expansion of, transmission facilities, or by restricting access to the ancillary services that control

the generation resources on the transmission grid.[176] To ensure that all participants in wholesale electricity markets have non-discriminatory open access to the transmission network, transmission owners must offer non-discriminatory open access transmission and ancillary services to wholesale sellers and purchasers of electric energy in interstate commerce.[177] This will require tariffs that offer point-to-point and network transmission services, including ancillary services. All of these services must be non-discriminatory as to price as well as to non-price terms and conditions. Services must be available to any entity that could obtain transmission services under section 211.

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In our *AEP* rehearing order and in several subsequent cases,[178] we set for hearing the following issues:

1. The different uses that a transmission owner

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[176] Examples of ancillary services (which include control area services) are: scheduling service between control areas, and various services that facilitate power movements within control areas, *e.g.*, dispatch service, load following service, imbalance resolution service, reactive power support, and operating reserves. We invite comment on definitions of these terms and their component parts. Regardless, the proposed rule would require that all ancillary services be offered on a non-discriminatory basis.

[177] *See generally* William W. Hogan, Reshaping the Electricity Industry, Prepared for the Federal Energy Bar Conference, "Turmoil for the Utilities," 5 Washington, D.C. (Nov. 17, 1994):

> Commercial functions must facilitate non-discriminatory, comparable open access and support market operations in the competitive sectors. The EPAct requirements and the FERC implementation emphasize the need to obtain market access under terms and conditions that support competition. Everyone should have equal access to and use of essential facilities, particularly transmission, with the rights of ownership limited to compensation consistent with opportunity costs in a competitive market.

[178] *See, e.g.*, AEP, 67 FERC at p. 61,491.

makes of its transmission system and whether there are any operational differences between any particular use that the owner makes of the system and the use third parties might need, and in particular, the degree of flexibility the transmission owner accords itself in using its transmission system for different purposes.

2. Any potential impediments or consequences to providing a particular service to third-party transmission customers which is the same or comparable to service that the transmission owner provides itself.

3. The costs that the transmission owner incurs in providing transmission associated with its use of the system, and whether the costs to provide such service or comparable service to third parties would be different.

Based on what we have learned in the past year, the Commission proposes to address these issues generically. Concurrently with this order, the Commission is issuing a separate order on how a final rule would apply to pending cases.[179] We believe that the parties and the administrative law judges in the individual pending proceedings should continue their efforts, but in doing so should take into account the principles announced in this proposed rule. This will permit any fine tuning of the broader principles announced here and set forth in the *pro forma* tariffs that may be necessary to recognize the individual circumstances of particular systems.

With regard to the first issue, the Commission believes that all utilities use their own systems in two basic ways: to

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[179] Order Providing Guidance Concerning Pending and Future Proceedings involving Non-discriminatory Open Access Transmission Services, Docket Nos. ER93-540-000, *et. al.*

provide themselves point-to-point transmission service that supports coordination sales, and to provide themselves network transmission service that supports the economic dispatch of their own generation units and purchased power resources (integrating their resources to meet their internal loads).[180] This network transmission service is bundled as part of retail service and as part of wholesale requirements service, and is the fundamental support of a utility's dispatch that underlies its trading in the wholesale coordination market.[181]

The Commission has preliminarily concluded that third parties may need one or both of these basic uses in order to obtain competitively priced generation or to have the opportunity to be competitive sellers of power. The Commission therefore proposes that all public utilities must offer both firm and non-firm point-to-point transmission service and firm network transmission service on a non-discriminatory open access basis in accord with the proposed rule and the attached tariffs. The Commission believes that a utility's tariff must offer to provide any point-to-point transmission service and network transmission service that customers need, even though the utility may not provide itself the specific service requested. For example, a utility

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[180] While there may be any number of specific services used by a particular customer, we have concluded, after analyzing the historical types of transmission service tariffs on file, as well as the tariffs filed in the ongoing comparability proceedings, that all transmission services generally fall within these two categories.

[181] A utility's own coordination purchases may involve hourly scheduled transfers of fixed blocks of power. These schedules are supported by the utility's own network transmission service used for its economic dispatch. Consequently, network service is covered by the proposed rule because it supports a utility's coordination purchases, regardless of whether or not the utility has any requirements customers that also would use network service.

may not provide itself "wheeling-through" service,[182] which is a specific form of point-to-point service. However, because "wheeling-through" service is merely a subset of basic point-to-point service, which the utility does provide to itself,

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the Commission will require a utility to provide such service.[183] Similarly, a utility may contend that it does not provide non-firm point-to-point service to itself because all of its transmission investment results in firm entitlements. Nonetheless, the utility provides itself with the functional equivalent of non-firm service when it uses, subject to curtailment or interruption, capacity that is temporarily unused by other firm reservation holders. Therefore, it must offer non-firm point-to-point service.

We will not allow transmission providers to define terms or specify transmission uses to erect barriers to fair and equal competition in power markets, or to engage in undue discrimination.

On the second issue set for hearing in *AEP, et al.* (potential impediments to providing a particular service), we believe there are none, except for impediments to siting. However, any impediments to siting are the same whether the utility is providing service to itself or to a third party.

On the third issue set for hearing *AEP, et al.* (the costs of providing comparable service), we believe there is no difference in the costs incurred by a transmission provider in providing transmission to itself or to a third party. Thus, the

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[182] "Wheeling through" refers to transmittal of electric energy through a transmitting utility's grid, *i.e.*, entering at one point of interconnection and leaving at another.

[183] This would be true of other services as well.

transmission owner must charge itself and third parties the same rates for the use of its system.

All electricity trade is supported and facilitated in one way or another by ancillary services, and transmission services may be comprised of many different combinations of ancillary services. Therefore, the Commission will require that such ancillary services be offered separately through open access tariffs. These are discussed in detail *infra*.

Public utilities that are transmission-only companies or transcos, *i.e.*, companies that do not own or control generation, do not use their own transmission systems to sell their own power. However, a public utility transco would be required to offer open access transmission services as well as ancillary services. It would also have to provide a real-time information network, as discussed below. The Commission is also announcing certain quality-of-service guidelines to aid in evaluating the quality of transmission service that must be provided by public utilities. These are described *infra* and are reflected in proposed *pro forma* point-to-point and network tariffs attached to this notice of proposed rulemaking. Our preliminary conclusion is that the provisions contained in the *pro forma* tariffs are the minimum provisions necessary to meet the requirement of non-discriminatory open access. We seek comments on these tariffs.

2. Implementing Non-discriminatory Open Access: Function-al Unbundling

The Commission's preliminary view is that functional unbundling of wholesale services is necessary to implement non-discriminatory open access. Accordingly, the proposed rule requires that a public utility's uses of its own transmission system for the purpose of engaging in wholesale sales and purchases of electric energy must be separated from other activities, and that transmission services (including ancillary services) must be taken under the filed transmission

tariff of general applicability. The proposed rule does not require corporate unbundling (selling off assets to a non-affiliate, or establishing a separate corporate affiliate to manage a utility's transmission assets) in any form, although some utilities may ultimately choose such a course of action. The proposed rule accommodates corporate unbundling, but does not require it.

Functional unbundling means three things. First, it means that a public utility must take transmission services (including ancillary services) for all of its new wholesale sales and purchases of energy under the same tariff of general applicability under which others take service. New wholesale sales and purchases are those under any contracts executed on or after the open access tariffs required by this proposed rule become effective. Non-discriminatory service requires that the utility charge itself the same price for these services that it charges its third-party wholesale transmission customers. We seek comment as to the appropriate means to enforce this requirement, such as a revenue crediting mechanism.

[33,081]

Second, functional unbundling means that a transmission owner must include in its open access tariffs separately stated rates for the transmission and ancillary service components of each transmission service it provides.[184] The rates must satisfy the Commission's Transmission Pricing Policy Statement. Third, functional unbundling means that the public utility, in order to provide non-discriminatory open access to transmission and ancillary services information,

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[184] This means that a customer who buys both generation and transmission services from the utility will have a separately stated rate for the generation, transmission, and ancillary services that it purchases. The rates for transmission and ancillary services would be stated in the open access tariff. The rates for the generation service would be under a separate rate schedule.

must rely upon the same electronic network that its transmission customers rely upon to obtain transmission information about its system when buying or selling power.

For example, the proposed rule requires that a public utility unbundle its new wholesale requirements service contracts, and its new wholesale coordination purchase transactions, and take the firm network transmission component of those services under its own firm network transmission tariff. Similarly, the proposed rule requires that a public utility unbundle any new wholesale coordination sales transactions and take the point-to-point transmission component of that service under its own point-to-point transmission tariff. Finally, the proposed rule requires that a utility unbundle ancillary services and take these services under its network and point-to-point tariffs.

Public utilities also must authorize their power pool agents to offer any transmission service available under power pool arrangements to all transmission customers. In addition, public utilities that participate in a power pool that acts as a control area must authorize the power pool's control center to offer ancillary services under a filed tariff, and must take all of their control area services from that tariff.[185] A public utility must take dispatch service and other ancillary transmission services on the same terms and conditions as those offered to its transmission customers.[186]

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[185] Similarly, public utilities that own transmission, but get their ancillary services from another entity must authorize that entity to provide ancillary services under a filed tariff and must take their ancillary services from that tariff.

[186] The Commission recognizes that the proposal here overlaps with the pending Pooling Notice of Inquiry. However, the fundamental non-discrimination requirements of the FPA, and therefore the basic requirements of the proposed rule, must be applied to power pools in which public utilities participate. This issue is discussed further in the Implementation Section *infra*.

The requirement to provide ancillary services and to take those services under a tariff is not intended to mandate any federal rules that would prescribe the actual merit order of dispatch. Rather, it is a requirement that public utilities ensure that dispatch practices and procedures applicable to them are also applied to third-party transmission customers.

The proposed requirement that a public utility take transmission service used for wholesale requirements service and wholesale coordination transactions under its own filed tariff means that all wholesale trade, both that of the public utility and its competitors, would be taken under a single wholesale transmission tariff. Our preliminary view is that such a requirement places the correct incentives on the public utility to file a fair tariff since it must live under those terms for wholesale purposes. The Commission invites comment on its approach to functional unbundling. Will it provide strong enough incentives for non-discriminatory access without some form of corporate restructuring? If utilities restructure, how will our proposed rules apply to different types of corporate structures?

While this approach to unbundling creates good incentives with respect to wholesale service, it omits retail service. In other words, it does not require the transmission owner to take unbundled transmission service under the same tariff as third parties in order to serve its retail customers. This will result in service under two separate arrangements—an explicit wholesale transmission tariff filed at the Commission and an implicit retail transmission tariff governed by a state regulatory body. It also raises the possibility that the quality of transmission service for retail purposes will be superior to

[33,082]

the quality of transmission service offered for wholesale purposes.

We seek comment on how this bifurcated approach would affect the public utility's incentives to provide non-discriminatory open access wholesale transmission service. For example, will planning of incremental transmission facilities be comparable or will the transmission provider's retail customers retain an advantage from having expansion costs placed on third parties? What would be the benefits of an approach that required the transmission provider to take unbundled transmission service for both wholesale and retail purposes under the same tariff used by third-party transmission customers? Is such an approach necessary to ensure that all participants have the same incentives to achieve non-discriminatory open access transmission service and competitive power markets? What would be the disadvantages, if any, of such an approach?

The Commission recognizes that the unbundling of transmission for retail purposes would intrude upon matters that state commissions have traditionally regulated. One possible approach that would unify service standards for wholesale and retail service would be for each vertically integrated utility to establish a distribution function that would be responsible for obtaining transmission service on behalf of retail customers. This distribution function then could be treated just as any other wholesale customer. The distribution function of the utility would take service under the single Commission filed tariff. This could change the traditional approach of state-federal allocation of transmission costs. The Commission seeks comment on the merits of such an approach. How could the Commission cooperate with state commissions if it were to adopt such an approach?

Finally, we address a specific type of retail service that we believe to be "bundled" retail service in name only: a so-called "buy-sell" transaction in which an *end user* arranges for the purchase of generation from a third-party supplier and a public utility transmits that energy in interstate commerce

and re-sells it as part of a "bundled" retail sale to the end user. We have determined that in these types of transactions the retail "bundled" sale is actually the functional equivalent of two unbundled retail sales: (1) a voluntary sale of unbundled transmission at retail in interstate commerce, subject to our exclusive jurisdiction;[187] and (2) a sale of unbundled generation at retail, subject to the state's jurisdiction.[188] For these types of sales, public utilities will have to provide the voluntary retail transmission component of the sale under a FERC-filed tariff consistent with the substantive requirements of this proposed rule.

We are aware that some public utilities are already contemplating initiating this type of "buy-sell" service. Similar services occurred in the natural gas area, but the Commission did not address the jurisdictional issue until a substantial number of transactions had been negotiated and implemented. When the Commission ultimately addressed the natural gas buy-sell programs, we concluded that we have jurisdiction over buy-sell transactions since such agreements utilize interstate transportation.[189] We were concerned then, just as we are concerned now, that interstate and intrastate programs operate together in an appropriately integrated way.[190] It is our preliminary view that the interstate transmission aspect of the buy-sell program must take place under a FERC-filed tariff.

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[187] As discussed *infra*, there would be a component of local distribution in such a transaction, subject to the state's jurisdiction.

[188] This determination is consistent with our findings regarding similar types of transactions in the natural gas area. *See El Paso Natural Gas Company*, 59 FERC ¶ 61,031 (1992), *dismissed sub nom. Windward Energy and Marketing Company v. FERC*, No. 92-1208 (D.C. Feb. 2, 1994).

[189] *Id.*

[190] 56 FERC ¶ 61,289 at p. 62,133 (1991).

In imposing this requirement we wish to stress that the state has jurisdiction to determine which group of retail customers may participate in such a program. We also recognize that state regulatory commissions will be called upon to determine whether they have jurisdiction under state law over retail wheeling or direct access programs and, if so, whether to authorize such programs.[191] However, the

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rates, terms, and conditions for the interstate transmission aspects of the program are jurisdictional to this Commission.

The Commission did not address this jurisdictional issue at an early state in the evolution of competition in the natural gas market. Consequently, when we finally acted we chose to grandfather ongoing programs so that energy supply arrangements would not be disrupted.[192] We do not want to face that difficulty again. Thus, we are addressing the issue at an early stage so that public utilities and their customers will be on notice of the jurisdictional implications of their actions, and can make plans accordingly.

3. Real-time Information Networks

With this proposed rule, the Commission is issuing a Notice of Technical Conference and Request for Comments on a proposal to require that public utilities provide all transmission users, including the transmission owner or controller, simultaneous access to transmission and ancillary services information through real-time information networks that would operate under industry-wide standards. Based upon the lessons we have learned from our experience with

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191 This Commission does not have authority to order retail wheeling. Section 212(h) of the Federal Power Act, as amended by the Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776.

192 59 FERC ¶ 61,031 (1992); *reh'g denied*, 60 FERC ¶ 61,117 (1992).

gas pipeline EBBs, we believe the proposed approach is necessary and can work.

4. Non-discriminatory Open Access Tariff Provisions

It is important that the tariffs filed to meet the non-discriminatory open access service requirement contain terms and conditions necessary to ensure a certain minimum level of service quality and to provide a level of certainty to both customers and transmission service providers as to procedures and obligations. The discussion in this section is intended to give guidance about our proposed non-discriminatory open access requirements. The terms and conditions discussed here are reflected in the *pro forma* tariffs in Appendices B and C.[193]

We note at the outset two basic principles proposed to be used when evaluating tariff terms. First, the terms and conditions governing service should be clear and specific. Vague or general tariff terms introduce uncertainty, controversy and delay. In many situations, delaying access or increasing the transaction cost of access is, for all practical purposes, denying access. Second, any restrictions or limitations on service or procedures must be limited to technical or operational needs that can be verified, and they must be the least restrictive way to meet those needs.[194]

The Commission invites comment on the terms and conditions proposed as well as whether others may be necessary.

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193 These Appendices will not appear in the Federal Register.

194 However, as discussed *infra*, in determining the level of capacity that must be made available for new transmission service requests, we have proposed that capacity needed to meet current and reasonably forecasted native load and to meet existing contractual obligations may be excluded from capacity made available for new transmission service requests.

a. *Customer eligibility.* A non-discriminatory open-access tariff must be available to any entity that can request transmission services under section 211.[195]

b. *Expansion obligation.* A public utility must offer to enlarge its transmission capacity (or expand its ancillary service facilities) if necessary to provide transmission services. This provision is necessary to mitigate the utility's transmission market power that could be exercised by restricting capacity. The customer must agree to reasonable terms, conditions and prices, including the financial responsibility for its share of the incremental expansion costs.[196]

[33,084]

The Commission recognizes that a utility may not be able to enlarge transmission capacity because it cannot obtain the necessary approvals or property rights under applicable Federal, state and local laws. If the utility has failed after making and documenting a good faith effort to obtain the necessary approvals or property rights, it can request to be relieved of its expansion obligation by an appropriate filing at the Commission.[197] This will result in consistent treatment under FPA sections 205 and 206 and FPA section 211.

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[195] Under Section 211, any electric utility, Federal power marketing agency, or any other person generating electric energy for sale for resale may request transmission services under section 211.

[196] *See, e.g., Northeast Utilities Service Company*, 56 FERC ¶ 61,269 at p. 62,202 (1991), *order on reh'g*, 58 FERC ¶ 61,070, *reh'g denied*, 59 FERC ¶ 61,042 (1992), *remanded*, 993 F.2d 937 (1st Cir. 1993), *order on remand*, 66 FERC ¶ 61,332 (1994) (*Northeast Utilities*) (wheeling customer must provide reasonable financial assurance before the public utility undertakes substantial investments in new facilities for that customer).

[197] However, we have previously noted that a utility may bear a heavy burden in demonstrating that it cannot enlarge its transmission capacity to

c. *Service obligation.* The transmission tariff must offer non-discriminatory transmission services (including related ancillary services that the utility can provide) to eligible transmission customers. For example, a tariff should make available both flexible (*i.e.*, firm and non-firm) point-to-point transmission service and network transmission service, as well as those ancillary services necessary to accomplish such transmission services.

(1) Network Transmission Service. Network transmission service allows a transmission customer to use the entire transmission network to provide generation service for specified resources and specified loads without having to pay a separate charge for each resource-load pairing. Such service allows a transmission customer to integrate, plan, commit, economically dispatch, and regulate its resources to serve its consolidated load. Network service provides the customer with the same flexible network usage needed to optimize its resources to meet its customers' needs that transmission owners have to optimize their resources to meet their customers' needs. Network service includes the ability to import power from other control areas to economically and reliably serve the customers' load. Non-discrimination requires that network service be made available in an open access tariff.

Network service would be valuable to customers such as municipals, cooperatives, and municipal joint action agencies that supply the long-term firm power needs of members with multiple loads that are wholly or partly within a single transmission system. Indeed, network service is essential for the resource integration that is needed for efficient operation. For example, a generation and transmission cooperative whose generating facilities and member cooperatives are widely dispersed may not own all of the transmission

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meet a new transmission request. *See Northeast Utilities*, 58 FERC at p. 61, 209.

facilities needed to link the generators with the members' distribution systems. In this case, the cooperative must rely on a transmission-owning utility to provide network service. Without such service, the cooperative would have difficulty supplying reliable, efficient power to its own members.

(2) Flexible Point-to-Point Service

The second required service in a non-discriminatory open access tariff is point-to-point transmission service. Both firm and non-firm service must be available on a point-to-point basis. Under firm point-to-point service, the transmission owner would provide firm deliveries of power from designated points of receipt to designated points of delivery. Each point of receipt would be set forth in a service agreement along with a corresponding capacity reservation for that point of receipt. Each point of delivery would be set forth in the service agreement along with a corresponding capacity reservation for that point of delivery. The greater of (1) the sum of the capacity reservations at the point(s) of receipt, or (2) the sum of the capacity reservations at the point(s) of delivery would be the firm capacity reservation for which the transmission customer would be charged.

However, firm point-to-point service must have the same flexibility in use as that available to the transmission provider and obligate the transmission provider to supply non-firm transmission service, if available, over non-designated receipt and delivery points (or over designated receipt and delivery points in excess of its firm reservation at those points) without incurring any additional charges (or executing a new service agreement) so long as the customer's use does not exceed its total firm capacity reservation. Any use by a customer in excess of its firm capacity reservation at each point of receipt or point of delivery will be

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on an as-available basis and will be treated as non-firm service. A customer may also request non-firm point-to-point transmission service on a stand-alone basis.

Transmission customers may be willing to trade off the higher risk of interruption with non-firm service for the lower non-firm transmission rate. Customers should be able to make that choice, which will depend on their own balancing of the risk of transmission service interruption with the interruptibility of, and trade gains associated with, the power resource. It is important that the customer, not the transmission provider, make this choice. The tariff should not restrict non-firm transmission service to the transporting of only non-firm power transactions.[198]

Tariffs should offer flexible point-to-point transmission service for transactions that involve power flows into, out of, within or through the control areas. Whether or not a transmission provider actually undertakes such specific services on its own behalf, it has the flexibility to do so. Therefore, if service to third parties is to be non-discriminatory, they, too, must have such flexibility. In addition, tariff restrictions on receipt and delivery points should not preclude particular types of transactions. For example, a transmission provider should not limit receipt and delivery points to points of interconnection with other transmission systems because such a restriction may preclude transactions that originate or terminate with generation or particular loads within a transmission provider's control area.

(3) Ancillary Services. Ancillary services are those services necessary to support the transmission of electric power from seller to purchaser given the obligations of control areas and transmitting utilities within those control areas to maintain reliable operations of the interconnected

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[198] See Entergy Services, Inc., 58 FERC ¶ 61,234 at p. 61,767, order on reh'g, 60 FERC ¶ 61,168 (1992), rev'd on other grounds sub nom.

transmission system. Basic transmission service without ancillary services may be of little or no value to prospective customers. A variety of ancillary services is needed in conjunction with providing basic transmission service to a customer. These services range from actions taken to effect the transaction (such as scheduling and dispatching services) to services that are necessary to maintain the integrity of the transmission system (such as load following, reactive power support, and system protection services). Other ancillary services are needed to correct for the effects associated with undertaking a transaction (such as loss compensation and energy imbalance services). Due to the nature of certain ancillary services (such as scheduling and dispatching service), the transmission provider may be uniquely positioned to provide these services. However, for other ancillary services (such as loss compensation service), the customer may wish to provide the service itself or purchase the service from a party other than the transmission owner or its agent.

If the transmission provider provides the ancillary services for its own use of the transmission system, the public utility should offer in the tariff to provide ancillary services for transmission customers. Tariffs should commit to provide specific ancillary services at specific prices or under specific compensation methods that are clearly described.

If the transmission provider obtains ancillary services from a third party, *e.g.*, does not operate its own control area or obtains ancillary services from a pool, the transmission provider should offer in the tariff to secure ancillary services for transmission customers from that third party. Examples of such third-party arrangements may include a public utility obtaining ancillary services from a power pool or from a control area operator.

Based on our experience to date, we propose that the following ancillary services should be offered in the tariff:

1. Reactive Power/Voltage Control Service

In order to maintain transmission voltages on the transmission provider's transmission facilities within acceptable limits, transmission facilities and some or all generation facilities (in the service area where the transmission provider's transmission facilities are located) are operated to produce (or absorb) reactive

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APPENDIX G

Statutory Provisions

APPENDIX G

STATUTORY PROVISIONS

[15 U.S.C. § 717]

§ 717. Regulation of natural gas companies

(a) Necessity of regulation in public interest

As disclosed in reports of the Federal Trade Commission made pursuant to S.Res. 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest.

(b) Transactions to which provisions of chapter applicable

The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

(c) Intrastate transactions exempt from provisions of chapter; certification from State commission as conclusive evidence

The provisions of this chapter shall not apply to any person engaged in or legally authorized to engage in the transportation in interstate commerce or the sale in interstate commerce for resale, of natural gas received by such person

from another person within or at the boundary of a State if all the natural gas so received is ultimately consumed within such State, or to any facilities used by such person for such transportation or sale, provided that the rates and service of such person and facilities be subject to regulation by a State commission. The matters exempted from the provisions of this chapter by this subsection are declared to be matters primarily of local concern and subject to regulation by the several States. A certification from such State commission to the Federal Power Commission that such State commission has regulatory jurisdiction over rates and service of such person and facilities and is exercising such jurisdiction shall constitute conclusive evidence of such regulatory power or jurisdiction.

(d) Vehicular natural gas jurisdiction

The provisions of this chapter shall not apply to any person solely by reason of, or with respect to, any sale or transportation of vehicular natural gas if such person is--

(1) not otherwise a natural-gas company; or

(2) subject primarily to regulation by a State commission, whether or not such State commission has, or is exercising, jurisdiction over the sale, sale for resale, or transportation of vehicular natural gas.

[15 U.S.C. § 717c]

§ 717c. Rates and charges

(a) Just and reasonable rates and charges

All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

(b) Undue preferences and unreasonable rates and charges prohibited

No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Filing of rates and charges with Commission; public inspection of schedules

Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from June 21, 1938) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Changes in rates and charges; notice to Commission

Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Authority of Commission to hold hearings concerning new schedule of rates

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective.

If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

[15 U.S.C. 717d]

§ 717d. Fixing rates and charges; determination of cost of production or transportation

(a) Decreases in rates

Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: Provided, however, That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) Costs of production and transportation

The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to

establish a rate governing the transportation or sale of such natural gas.

[16 U.S.C. § 824]

§ 824. Declaration of policy; application of subchapter

(a) Federal regulation of transmission and sale of electric energy

It is declared that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation of matters relating to generation to the extent provided in this subchapter and subchapter III of this chapter and of that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States.

(b) Use or sale of electric energy in interstate commerce

(1) The provisions of this subchapter shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce, but except as provided in paragraph (2) shall not apply to any other sale of electric energy or deprive a State or State commission of its lawful authority now exercised over the exportation of hydroelectric energy which is transmitted across a State line. The Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction, except as specifically provided in this subchapter and subchapter III of this chapter, over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter.

(2) The provisions of sections 824i, 824j, and 824k of this title shall apply to the entities described in such provisions, and such entities shall be subject to the jurisdiction of the Commission for purposes of carrying out such provisions and for purposes of applying the enforcement authorities of this chapter with respect to such provisions. Compliance with any order of the Commission under the provisions of section 824i or 824j of this title, shall not make an electric utility or other entity subject to the jurisdiction of the Commission for any purposes other than the purposes specified in the preceding sentence.

(c) Electric energy in interstate commerce

For the purpose of this subchapter, electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof; but only insofar as such transmission takes place within the United States.

(d) "Sale of electric energy at wholesale" defined

The term "sale of electric energy at wholesale" when used in this subchapter, means a sale of electric energy to any person for resale.

(e) "Public utility" defined

The term "public utility" when used in this subchapter and subchapter III of this chapter means any person who owns or operates facilities subject to the jurisdiction of the Commission under this subchapter (other than facilities subject to such jurisdiction solely by reason of section 824i, 824j, or 824k of this title).

(f) United States, State, political subdivision of State, or agency or instrumentality thereof exempt

No provision in this subchapter shall apply to, or be deemed to include, the United States, a State or any political subdivision of a State, or any agency, authority, or

instrumentality of any one or more of the foregoing, or any corporation which is wholly owned, directly or indirectly, by any one or more of the foregoing, or any officer, agent, or employee of any of the foregoing acting as such in the course of his official duty, unless such provision makes specific reference thereto.

(g) Books and records

(1) Upon written order of a State commission, a State commission may examine the books, accounts, memoranda, contracts, and records of--

(A) an electric utility company subject to its regulatory authority under State law,

(B) any exempt wholesale generator selling energy at wholesale to such electric utility, and

(C) any electric utility company, or holding company thereof, which is an associate company or affiliate of an exempt wholesale generator which sells electric energy to an electric utility company referred to in subparagraph (A),

wherever located, if such examination is required for the effective discharge of the State commission's regulatory responsibilities affecting the provision of electric service.

(2) Where a State commission issues an order pursuant to paragraph (1), the State commission shall not publicly disclose trade secrets or sensitive commercial information.

(3) Any United States district court located in the State in which the State commission referred to in paragraph (1) is located shall have jurisdiction to enforce compliance with this subsection.

(4) Nothing in this section shall--

(A) preempt applicable State law concerning the provision of records and other information; or

(B) in any way limit rights to obtain records and other information under Federal law, contracts, or otherwise.

(5) As used in this subsection the terms "affiliate", "associate company", "electric utility company", "holding company", "subsidiary company", and "exempt wholesale generator" shall have the same meaning as when used in the Public Utility Holding Company Act of 1935 [15 U.S.C.A. § 79 et seq.].

[16 U.S.C. § 824d]

§ 824d. Rates and charges; schedules; suspension of new rates; automatic adjustment clauses

(a) Just and reasonable rates

All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) Preference or advantage unlawful

No public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Schedules

Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Notice required for rate changes

Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after sixty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the sixty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Suspension of new rates; hearings; five-month period

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint or upon its own initiative without complaint, at once, and, if it so orders, without answer or formal pleading by the public utility, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of such five months, the proposed change of rate, charge, classification, or service shall go into effect at the end

of such period, but in case of a proposed increased rate or charge, the Commission may by order require the interested public utility or public utilities to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require such public utility or public utilities to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

(f) Review of automatic adjustment clauses and public utility practices; action by Commission; "automatic adjustment clause" defined

(1) Not later than 2 years after November 9, 1978 and not less often than every 4 years thereafter, the Commission shall make a thorough review of automatic adjustment clauses in public utility rate schedules to examine—

(A) whether or not each such clause effectively provides incentives for efficient use of resources (including economical purchase and use of fuel and electric energy), and

(B) whether any such clause reflects any costs other than costs which are—

(i) subject to periodic fluctuations and

(ii) not susceptible to precise determinations in rate cases prior to the time such costs are incurred.

Such review may take place in individual rate proceedings or in generic or other separate proceedings applicable to one or more utilities.

(2) Not less frequently than every 2 years, in rate proceedings or in generic or other separate proceedings, the Commission shall review, with respect to each public utility, practices under any automatic adjustment clauses of such utility to insure efficient use of resources (including economical purchase and use of fuel and electric energy) under such clauses.

(3) The Commission may, on its own motion or upon complaint, after an opportunity for an evidentiary hearing, order a public utility to

(A) modify the terms and provisions of any automatic adjustment clause, or

(B) cease any practice in connection with the clause,

if such clause or practice does not result in the economical purchase and use of fuel, electric energy, or other items, the cost of which is included in any rate schedule under an automatic adjustment clause.

(4) As used in this subsection, the term "automatic adjustment clause" means a provision of a rate schedule which provides for increases or decreases (or both), without prior hearing, in rates reflecting increases or decreases (or both) in costs incurred by an electric utility. Such term does not include any rate which takes effect subject to refund and subject to a later determination of the appropriate amount of such rate.

[16 U.S.C. § 824e]

§ 824e. Power of Commission to fix rates and charges; determination of cost of production or transmission

(a) Unjust or preferential rates, etc.; statement of reasons for changes; hearing; specification of issues

Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. Any complaint or motion of the Commission to initiate a proceeding under this section shall state the change or changes to be made in the rate, charge, classification, rule, regulation, practice, or contract then in force, and the reasons for any proposed change or changes therein. If, after review of any motion or complaint and answer, the Commission shall decide to hold a hearing, it shall fix by order the time and place of such hearing and shall specify the issues to be adjudicated.

(b) Refund effective date; preferential proceedings; statement of reasons for delay; burden of proof; scope of refund order; refund orders in cases of dilatory behavior; interest

Whenever the Commission institutes a proceeding under this section, the Commission shall establish a refund effective date. In the case of a proceeding instituted on complaint, the refund effective date shall not be earlier than

the date 60 days after the filing of such complaint nor later than 5 months after the expiration of such 60-day period. In the case of a proceeding instituted by the Commission on its own motion, the refund effective date shall not be earlier than the date 60 days after the publication by the Commission of notice of its intention to initiate such proceeding nor later than 5 months after the expiration of such 60-day period. Upon institution of a proceeding under this section, the Commission shall give to the decision of such proceeding the same preference as provided under section 824d of this title and otherwise act as speedily as possible. If no final decision is rendered by the refund effective date or by the conclusion of the 180-day period commencing upon initiation of a proceeding pursuant to this section, whichever is earlier, the Commission shall state the reasons why it has failed to do so and shall state its best estimate as to when it reasonably expects to make such decision. In any proceeding under this section, the burden of proof to show that any rate, charge, classification, rule, regulation, practice, or contract is unjust, unreasonable, unduly discriminatory, or preferential shall be upon the Commission or the complainant. At the conclusion of any proceeding under this section, the Commission may order the public utility to make refunds of any amounts paid, for the period subsequent to the refund effective date through a date fifteen months after such refund effective date, in excess of those which would have been paid under the just and reasonable rate, charge, classification, rule, regulation, practice, or contract which the Commission orders to be thereafter observed and in force: Provided, That if the proceeding is not concluded within fifteen months after the refund effective date and if the Commission determines at the conclusion of the proceeding that the proceeding was not resolved within the fifteen-month period primarily because of dilatory behavior by the public utility, the Commission may order refunds of any or all amounts paid for the period subsequent to the refund effective date and prior to the conclusion of the proceeding. The refunds shall be made,

with interest, to those persons who have paid those rates or charges which are the subject of the proceeding.

(c) Refund considerations; shifting costs; reduction in revenues; "electric utility companies" and "registered holding company" defined

Notwithstanding subsection (b) of this section, in a proceeding commenced under this section involving two or more electric utility companies of a registered holding company, refunds which might otherwise be payable under subsection (b) of this section shall not be ordered to the extent that such refunds would result from any portion of a Commission order that (1) requires a decrease in system production or transmission costs to be paid by one or more of such electric companies; and (2) is based upon a determination that the amount of such decrease should be paid through an increase in the costs to be paid by other electric utility companies of such registered holding company: Provided, That refunds, in whole or in part, may be ordered by the Commission if it determines that the registered holding company would not experience any reduction in revenues which results from an inability of an electric utility company of the holding company to recover such increase in costs for the period between the refund effective date and the effective date of the Commission's order. For purposes of this subsection, the terms "electric utility companies" and "registered holding company" shall have the same meanings as provided in the Public Utility Holding Company Act of 1935, as amended [15 U.S.C.A. § 79 et seq.].

(d) Investigation of costs

The Commission upon its own motion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of

facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.

[16 U.S.C. § 824j]

§ 824j. Wheeling authority

(a) Transmission service by any electric utility; notice, hearing and findings by Commission

Any electric utility, Federal power marketing agency, or any other person generating electric energy for sale for resale, may apply to the Commission for an order under this subsection requiring a transmitting utility to provide transmission services (including any enlargement of transmission capacity necessary to provide such services) to the applicant. Upon receipt of such application, after public notice and notice to each affected State regulatory authority, each affected electric utility, and each affected Federal power marketing agency, and after affording an opportunity for an evidentiary hearing, the Commission may issue such order if it finds that such order meets the requirements of section 824k of this title, and would otherwise be in the public interest. No order may be issued under this subsection unless the applicant has made a request for transmission services to the transmitting utility that would be the subject of such order at least 60 days prior to its filing of an application for such order.

(b) Reliability of electric service

No order may be issued under this section or section 824i of this title if, after giving consideration to consistently applied regional or national reliability standards, guidelines, or criteria, the Commission finds that such order would unreasonably impair the continued reliability of electric systems affected by the order.

(c) Replacement of electric energy

(1) Repealed. Pub.L. 102-486, Title VII, § 721(4)(A), Oct. 24, 1992, 106 Stat. 2915

(2) No order may be issued under subsection (a) or (b) of this section which requires the transmitting utility subject to the order to transmit, during any period, an amount of electric energy which replaces any amount of electric energy--

(A) required to be provided to such applicant pursuant to a contract during such period, or

(B) currently provided to the applicant by the utility subject to the order pursuant to a rate schedule on file during such period with the Commission: Provided, That nothing in this subparagraph shall prevent an application for an order hereunder to be filed prior to termination of [FN1] modification of an existing rate schedule: Provided, That such order shall not become effective until termination of such rate schedule or the modification becomes effective.

(3), (4) Repealed. Pub.L. 102-486, Title VII, § 721(4)(C), Oct. 24, 1992, 106 Stat. 2915

(d) Termination or modification of order; notice, hearing and findings of Commission; contents of order; inclusion in order of terms and conditions agreed upon by parties

(1) Any transmitting utility ordered under subsection (a) or (b) of this section to provide transmission services may apply to the Commission for an order permitting such transmitting utility to cease providing all, or any portion of, such services. After public notice, notice to each affected State regulatory authority, each affected Federal power marketing agency, each affected transmitting utility, and each affected electric utility, and after an opportunity for an evidentiary hearing, the Commission shall issue an order terminating or modifying the order issued under subsection (a) or (b) of this section, if the electric utility providing such transmission services has demonstrated, and the Commission has found, that--

(A) due to changed circumstances, the requirements applicable, under this section and section 824k of this title, to the issuance of an order under subsection (a) or (b) of this section are no longer met, or

(B) any transmission capacity of the utility providing transmission services under such order which was, at the time such order was issued, in excess of the capacity necessary to serve its own customers is no longer in excess of the capacity necessary for such purposes, or

(C) the ordered transmission services require enlargement of transmission capacity and the transmitting utility subject to the order has failed, after making a good faith effort, to obtain the necessary approvals or property rights under applicable Federal, State, and local laws.

No order shall be issued under this subsection pursuant to a finding under subparagraph (A) unless the Commission finds that such order is in the public interest.

(2) Any order issued under this subsection terminating or modifying an order issued under subsection (a) or (b) of this section shall--

(A) provide for any appropriate compensation, and

(B) provide the affected electric utilities adequate opportunity and time to--

(i) make suitable alternative arrangements for any transmission services terminated or modified, and

(ii) insure that the interests of ratepayers of such utilities are adequately protected.

(3) No order may be issued under this subsection terminating or modifying any order issued under subsection (a) or (b) of this section if the order under subsection (a) or (b) of this section includes terms and conditions agreed upon by the parties which--

(A) fix a period during which transmission services are to be provided under the order under subsection (a) or (b) of this section, or

(B) otherwise provide procedures or methods for terminating or modifying such order (including, if appropriate, the return of the transmission capacity when necessary to take into account an increase, after the issuance of such order, in the needs of the transmitting utility subject to such order for transmission capacity).

(e) "Facilities" defined

As used in this section, the term "facilities" means only facilities used for the generation or transmission of electric energy.

[16 U.S.C. § 824k]

§ 824k. Orders requiring interconnection or wheeling

(a) Rates, charges, terms, and conditions for wholesale transmission services

An order under section 824j of this title shall require the transmitting utility subject to the order to provide wholesale transmission services at rates, charges, terms, and conditions which permit the recovery by such utility of all the costs incurred in connection with the transmission services and necessary associated services, including, but not limited to, an appropriate share, if any, of legitimate, verifiable and economic costs, including taking into account any benefits to the transmission system of providing the transmission service, and the costs of any enlargement of transmission facilities. Such rates, charges, terms, and conditions shall promote the economically efficient transmission and generation of electricity and shall be just and reasonable, and not unduly discriminatory or preferential. Rates, charges, terms, and conditions for transmission services provided pursuant to an order under section 824j of this title shall ensure that, to the extent practicable, costs incurred in providing the wholesale transmission services, and properly allocable to the provision of such services, are recovered from the applicant for such order and not from a transmitting utility's existing wholesale, retail, and transmission customers.

(b) Repealed. Pub.L. 102-486, Title VII, §722(1), Oct. 24, 1992, 106 Stat. 2916

(c) Issuance of proposed order; agreement by parties to terms and conditions of order; approval by Commission; inclusion in final order; failure to agree

(1) Before issuing an order under section 824i of this title or subsection (a) or (b) of section 824j of this title,

the Commission shall issue a proposed order and set a reasonable time for parties to the proposed interconnection or transmission order to agree to terms and conditions under which such order is to be carried out, including the apportionment of costs between them and the compensation or reimbursement reasonably due to any of them. Such proposed order shall not be reviewable or enforceable in any court. The time set for such parties to agree to such terms and conditions may be shortened if the Commission determines that delay would jeopardize the attainment of the purposes of any proposed order. Any terms and conditions agreed to by the parties shall be subject to the approval of the Commission.

(2) (A) If the parties agree as provided in paragraph (1) within the time set by the Commission and the Commission approves such agreement, the terms and conditions shall be included in the final order. In the case of an order under section 824i of this title, if the parties fail to agree within the time set by the Commission or if the Commission does not approve any such agreement, the Commission shall prescribe such terms and conditions and include such terms and conditions in the final order.

(B) In the case of any order applied for under section 824j of this title, if the parties fail to agree within the time set by the Commission, the Commission shall prescribe such terms and conditions in the final order.

(d) Statement of reasons for denial

If the Commission does not issue any order applied for under section 824i or 824j of this title, the Commission shall, by order, deny such application and state the reasons for such denial.

(e) Savings provisions

(1) No provision of section 824i, 824j, 824m of this title, or this section shall be treated as requiring any person to utilize the authority of any such section in lieu of any other authority of law. Except as provided in section 824i, 824j, 824m of this title, or this section, such sections shall not be construed as limiting or impairing any authority of the Commission under any other provision of law.

(2) Sections 824i, 824j, 824l, 824m of this title, and this section, shall not be construed to modify, impair, or supersede the antitrust laws. For purposes of this section, the term "antitrust laws" has the meaning given in subsection (a) of the first sentence of section 12 of Title 15, except that such term includes section 45 of Title 15 to the extent that such section relates to unfair methods of competition.

(f) Effective date of order; hearing; notice; review

(1) No order under section 824i or 824j of this title requiring the Tennessee Valley Authority (hereinafter in this subsection referred to as the "TVA") to take any action shall take effect for 60 days following the date of issuance of the order. Within 60 days following the issuance by the Commission of any order under section 824i or of section 824j of this title requiring the TVA to enter into any contract for the sale or delivery of power, the Commission may on its own motion initiate, or upon petition of any aggrieved person shall initiate, an evidentiary hearing to determine whether or not such sale or delivery would result in violation of the third sentence of section 15d(a) of the Tennessee Valley Authority Act of 1933 (16 U.S.C. 831n-4), hereinafter in this subsection referred to as the TVA Act [16 U.S.C.A. § 831 et seq.]

(2) Upon initiation of any evidentiary hearing under paragraph (1), the Commission shall give notice thereof to any applicant who applied for and obtained the order from the Commission, to any electric utility or other

entity subject to such order, and to the public, and shall promptly make the determination referred to in paragraph (1). Upon initiation of such hearing, the Commission shall stay the effectiveness of the order under section 824i or 824j of this title until whichever of the following dates is applicable--

(A) the date on which there is a final determination (including any judicial review thereof under paragraph (3)) that no such violation would result from such order, or

(B) the date on which a specific authorization of the Congress (within the meaning of the third sentence of section 15d(a) of the TVA Act [16 U.S.C.A. § 831n-4(a)]) takes effect.

(3) Any determination under paragraph (1) shall be reviewable only in the appropriate court of the United States upon petition filed by any aggrieved person or municipality within 60 days after such determination, and such court shall have jurisdiction to grant appropriate relief. Any applicant who applied for and obtained the order under section 824i or 824j of this title, and any electric utility or other entity subject to such order shall have the right to intervene in any such proceeding in such court. Except for review by such court (and any appeal or other review by an appellate court of the United States), no court shall have jurisdiction to consider any action brought by any person to enjoin the carrying out of any order of the Commission under section 824i or section 824j of this title requiring the TVA to take any action on the grounds that such action requires a specific authorization of the Congress pursuant to the third sentence of section 15d(a) of the TVA Act [16 U.S.C.A. § 831n-4(a)].

(g) Prohibition on orders inconsistent with retail marketing areas

No order may be issued under this chapter which is inconsistent with any State law which governs the retail marketing areas of electric utilities.

(h) Prohibition on mandatory retail wheeling and sham wholesale transactions

No order issued under this chapter shall be conditioned upon or require the transmission of electric energy:

(1) directly to an ultimate consumer, or

(2) to, or for the benefit of, an entity if such electric energy would be sold by such entity directly to an ultimate consumer, unless:

(A) such entity is a Federal power marketing agency; the Tennessee Valley Authority; a State or any political subdivision of a State (or an agency, authority, or instrumentality of a State or a political subdivision); a corporation or association that has ever received a loan for the purposes of providing electric service from the Administrator of the Rural Electrification Administration under the Rural Electrification Act of 1936 [7 U.S.C.A. § 901 et seq.]; a person having an obligation arising under State or local law (exclusive of an obligation arising solely from a contract entered into by such person) to provide electric service to the public; or any corporation or association which is wholly owned, directly or indirectly, by any one or more of the foregoing; and

(B) such entity was providing electric service to such ultimate consumer on October 24, 1992, or would utilize transmission or distribution facilities that it owns or controls to deliver all such electric energy to such electric consumer.

Nothing in this subsection shall affect any authority of any State or local government under State law concerning the

transmission of electric energy directly to an ultimate consumer.

(i) Laws applicable to Federal Columbia River Transmission System

(1) The Commission shall have authority pursuant to section 824i of this title, section 824j of this title, this section, and section 824l of this title to (A) order the Administrator of the Bonneville Power Administration to provide transmission service and (B) establish the terms and conditions of such service. In applying such sections to the Federal Columbia River Transmission System, the Commission shall assure that--

(i) the provisions of otherwise applicable Federal laws shall continue in full force and effect and shall continue to be applicable to the system; and

(ii) the rates for the transmission of electric power on the system shall be governed only by such otherwise applicable provisions of law and not by any provision of section 824i of this title, section 824j of this title, this section, or section 824l of this title, except that no rate for the transmission of power on the system shall be unjust, unreasonable, or unduly discriminatory or preferential, as determined by the Commission.

(2) Notwithstanding any other provision of this chapter with respect to the procedures for the determination of terms and conditions for transmission service--

(A) when the Administrator of the Bonneville Power Administration either (i) in response to a written request for specific transmission service terms and conditions does not offer the requested terms and conditions, or (ii) proposes to establish terms and conditions of general applicability for transmission service on the Federal Columbia River

Transmission System, then the Administrator may provide opportunity for a hearing and, in so doing, shall--

(I) give notice in the Federal Register and state in such notice the written explanation of the reasons why the specific terms and conditions for transmission services are not being offered or are being proposed;

(II) adhere to the procedural requirements of paragraphs (1) through (3) of section 839e(i) of this title, except that the hearing officer shall, unless the hearing officer becomes unavailable to the agency, make a recommended decision to the Administrator that states the hearing officer's findings and conclusions, and the reasons or basis thereof, on all material issues of fact, law, or discretion presented on the record; and

(III) make a determination, setting forth the reasons for reaching any findings and conclusions which may differ from those of the hearing officer, based on the hearing record, consideration of the hearing officer's recommended decision, section 824j of this title and this section, as amended by the Energy Policy Act of 1992, and the provisions of law as preserved in this section; and

(B) if application is made to the Commission under section 824j of this title for transmission service under terms and conditions different than those offered by the Administrator, or following the denial of a request for transmission service by the Administrator, and such application is filed within 60 days of the Administrator's final determination

and in accordance with Commission procedures, the Commission shall--

(i) in the event the Administrator has conducted a hearing as herein provided for (I) accord parties to the Administrator's hearing the opportunity to offer for the Commission record materials excluded by the Administrator from the hearing record, (II) accord such parties the opportunity to submit for the Commission record comments on appropriate terms and conditions, (III) afford those parties the opportunity for a hearing if and to the extent that the Commission finds the Administrator's hearing record to be inadequate to support a decision by the Commission, and (IV) establish terms and conditions for or deny transmission service based on the Administrator's hearing record, the Commission record, section 824j of this title and this section, as amended by the Energy Policy Act of 1992, and the provisions of law as preserved in this section, or

(ii) in the event the Administrator has not conducted a hearing as herein provided for, determine whether to issue an order for transmission service in accordance with section 824j of this title and this section, including providing the opportunity for a hearing.

(3) Notwithstanding those provisions of section 825l(b) of this title which designate the court in which review may be obtained, any party to a proceeding concerning transmission service sought to be furnished by the Administrator of the Bonneville Power Administration seeking review of an order issued by the Commission in such proceeding shall obtain a review of such order in the United States Court of Appeals for the Pacific

Northwest, as that region is defined by section 839a(14) of this title.

(4) To the extent the Administrator of the Bonneville Power Administration cannot be required under section 824j of this title, as a result of the Administrator's other statutory mandates, either to (A) provide transmission service to an applicant which the Commission would otherwise order, or (B) provide such service under rates, terms, and conditions which the Commission would otherwise require, the applicant shall not be required to provide similar transmission services to the Administrator or to provide such services under similar rates, terms, and conditions.

(5) The Commission shall not issue any order under section 824i of this title, section 824j of this title, this section, or section 824l of this title requiring the Administrator of the Bonneville Power Administration to provide transmission service if such an order would impair the Administrator's ability to provide such transmission service to the Administrator's power and transmission customers in the Pacific Northwest, as that region is defined in section 839a(14) of this title, as is needed to assure adequate and reliable service to loads in that region.

(j) Equitability within territory restricted electric systems

With respect to an electric utility which is prohibited by Federal law from being a source of power supply, either directly or through a distributor of its electric energy, outside an area set forth in such law, no order issued under section 824j of this title may require such electric utility (or a distributor of such electric utility) to provide transmission services to another entity if the electric energy to be transmitted will be consumed within the area set forth in such Federal law, unless the order is in furtherance of a sale of electric energy to that electric utility: Provided, however,

That the foregoing provision shall not apply to any area served at retail by an electric transmission system which was such a distributor on October 24, 1992 and which before October 1, 1991, gave its notice of termination under its power supply contract with such electric utility.

(k) ERCOT utilities

(1) Rates

Any order under section 824j of this title requiring provision of transmission services in whole or in part within ERCOT shall provide that any ERCOT utility which is not a public utility and the transmission facilities of which are actually used for such transmission service is entitled to receive compensation based, insofar as practicable and consistent with subsection (a) of this section, on the transmission ratemaking methodology used by the Public Utility Commission of Texas.

(2) Definitions

For purposes of this subsection--

(A) the term "ERCOT" means the Electric Reliability Council of Texas; and

(B) the term "ERCOT utility" means a transmitting utility which is a member of ERCOT.

[16 U.S.C. § 824l]

§ 824l. Information requirements

(a) Requests for wholesale transmission services

Whenever any electric utility, Federal power marketing agency, or any other person generating electric energy for sale for resale makes a good faith request to a transmitting utility to provide wholesale transmission services and requests specific rates and charges, and other terms and conditions, unless the transmitting utility agrees to provide such services at rates, charges, terms and conditions acceptable to such person, the transmitting utility shall, within 60 days of its receipt of the request, or other mutually agreed upon period, provide such person with a detailed written explanation, with specific reference to the facts and circumstances of the request, stating (1) the transmitting utility's basis for the proposed rates, charges, terms, and conditions for such services, and (2) its analysis of any physical or other constraints affecting the provision of such services.

(b) Transmission capacity and constraints

Not later than 1 year after the enactment of this section, the Commission shall promulgate a rule requiring that information be submitted annually to the Commission by transmitting utilities which is adequate to inform potential transmission customers, State regulatory authorities, and the public of potentially available transmission capacity and known constraints.

[16 U.S.C. § 825l]

§ 825l. Review of orders

(a) Application for rehearing; time periods; modification of order

Any person, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this chapter to which such person, State, municipality, or State commission is a party may apply for a rehearing within thirty days after the issuance of such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any order of the Commission shall be brought by any person unless such person shall have made application to the Commission for a rehearing thereon. Until the record in a proceeding shall have been filed in a court of appeals, as provided in subsection (b) of this section, the Commission may at any time, upon reasonable notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any finding or order made or issued by it under the provisions of this chapter.

(b) Judicial review

Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the United States Court of Appeals for any circuit wherein the licensee or public utility to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within

sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of Title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of Title 28.

(c) Stay of Commission's order

The filing of an application for rehearing under subsection (a) of this section shall not, unless specifically ordered by the Commission, operate as a stay of the Commission's order. The commencement of proceedings under subsection (b) of this section shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.

APPENDIX H

List of Parties to the Proceeding

APPENDIX H

LIST OF PARTIES TO THE PROCEEDING

Pursuant to Rule 14 of the Supreme Court of the United States, the petitioners and intervenors before the Court below are as follows:

Action Alliance of Senior Citizens of Greater Pennsylvania

Alabama Power Company, et al. (The Southern Companies)

American Forest & Paper Association

American Iron And Steel Institute

American Public Power Association

Arkansas Public Service Commission

Atlantic City Electric Company

Board of Water, Light And Sinking Fund Comm'ns of City of Dalton, Georgia

Boston Edition Company, et al.

Cajun Electric Power Coop. Inc. (Trustee)

Carolina Power & Light Company

Central Montana Electric Power Cooperative, Inc.

Central Vermont Public Service Corporation

Chemical Manufacturers Association

Cincinnati Gas & Electric Co.

Cities of Benton, et al.

Citizens Action Coalition of Indiana, Inc.

Citizens For a Sound Economy

Citizens Power, Inc.

The City and County of San Francisco

City of Alma, Michigan

City of Cleveland, Ohio

City of Lakeland, Florida

City of Tallahassee, Florida

Coalition For Economic Competition

Commission and The Public Staff of The North Carolina Utilities Comm'n

Commonwealth Edison Company

Consolidated Edison Company of New York, Inc.

Consumer Energy Company

Council of Industrial Boiler Owners

CSW Operating Companies
(Central Power & Light Company, West Texas Utilities Company, Public Service Company of Oklahoma and Southwestern Electric Power Company) -

Dairyland Power Cooperative

The Dayton Power and Light Co.

The Detroit Edison Company

Duke Energy Trading And Marketing
(Formerly PANENERGY Trading and Market Services)

Edison Electric Institute

El Paso Electric Company

Electric Clearinghouse, Inc.

Electric Power Supply Association

Electricity Consumers Resource Council

ENRON Power Marketing

ENTERGY Services Inc.

Federal Energy Regulatory Commission

First Energy Corp.
(Formerly Ohio Edison Company, the Cleveland Electric Illuminating Co., and The Toledo Edison Co.)

Florida Municipal Power Agency

Florida Power & Light Company

Florida Power Corporation

Florida Public Service Commission

Gainesville Regional Utilities

Georgia Transmission Corporation

GPU Energy Companies
(Formerly, General Public Utilities Service, Inc.)

H.Q. Energy Services (U.S.)

Hydro-Quebec

Idaho Public Utilities Commission

Illinois Commerce Commission

Illinois Power Company

Indiana Industrial Energy Consumers, Inc.

Indiana Office of Utility Consumer Counselor

Indianapolis Power & Light Co.

Jacksonville Electric Authority

Kansas City Power & Light Company

Kissimmee Utility Authority

Long Island Lighting Co.

Louisiana Energy And Power Authority

Massachusetts Municipal Wholesale Electric Company

Michigan South Central Power Agency

Multiple Intervenors

Municipal Electric Utilities of Wisconsin

National Association of Regulatory Utility Commissioners

National Association of State Utility Consumer Advocates

National Rural Electric Cooperative Association

Nebraska Public Power District

New England Electric Service

New England Power Company

New Jersey Board of Public Utilities

New York State Electric & Gas Corporation

Niagara Mohawk Power Corp.

North Carolina Utilities

Northeast Texas Electric Cooperative of Texas, Inc.

Northeast Utilities Service Company and Northeast Utilities

Ohio Consumers' Counsel

Ontario Hydro

PANENERGY Trading and Market Services

Pennsylvania Consumer Action Network

Pennsylvania Municipal Electric Association

Pennsylvania Rural Electric Association, et al.

People of The State of New York, et al. and Public Service Commission of The State of New York

PSI Energy, Inc.

Public Citizen, Inc.

Public Power Association of New Jersey

Public Service Commission of Florida

Public Service Commission of New York

Public Service Commission of Wyoming
Public Service Company of New Mexico
Public Service Electric & Gas Company
Public Utilities Commission of Idaho
Public Utilities Commission of North Carolina
Public Utilities Commission of The State of Colorado
Puget Sound Energy, Inc.
Rochester Gas & Electric Corporation
Safe Energy Communication Council
Sam Rayburn G&T Electric
San Diego Gas & Electric Co.
SASKPOWER
South Carolina Electric & Gas Company
Southern California Edison Co.
Southern California Gas Company
Suffolk County Electric Agency
Tex-La Electric Cooperative of Texas, Inc.
Transmission Access Policy Study Group
Transmission Dependent Utility Systems
U.S. Public Interest Research Group
United Homeowners Association
Vermont Board of Public Utilities
Vermont Department of Public Service
Virginia Electric & Power Co.
Virginia State Corporation Commission
Washington Utilities and Transportation Commission

Wisconsin Power & Light Co.

Wisconsin Public Service Corp.

Wolverine Power Supply Cooperative, Inc.

Wyoming Public Service Commission

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Nos. 00-568, 00-800, and 00-809

IN THE

Supreme Court of the United States

PEOPLE OF THE STATE OF NEW YORK AND THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, *et al.*,

Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

---

BRIEF OF RESPONDENT TRANSMISSION ACCESS POLICY STUDY GROUP

ROBERT C. MCDIARMID
Counsel of Record
CYNTHIA S. BOGORAD
BEN FINKELSTEIN
PETER J. HOPKINS
SPIEGEL & MCDIARMID
1350 New York Ave., NW
Suite 1100
Washington, DC 20005
(202) 879-4000

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ARGUMENT

Respondent Transmission Access Policy Study Group ("TAPS")[1] respectfully requests that this Court deny the petitions of the States and Dalton for writ of certiorari, seeking review of the District of Columbia Circuit's opinion. Because Dalton's petition is without merit and warrants little discussion,[2] TAPS addresses only the States' petition below.[3] TAPS believes that Petitioner Enron Power Marketing, Inc.'s position is correct, but because under the D.C. Circuit's opinion the Federal Energy Regulatory Commission ("FERC") may choose to exercise jurisdiction in the future over all interstate transmission by public utilities, including transmission used for "bundled"[4] retail electric sales, there is no need for the Court to review the issue now. However, should the Court grant States' petition then it should also grant Enron's petition to permit a complete assessment of the issues.

The opinion is reported at 225 F.3d 667, *amended*, 2000 U.S. App. LEXIS 15362 (D.C. Cir. Nov. 14, 2000).

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[1] TAPS is an informal association of municipal, cooperative and investor-owned utilities and other supporters in more than 29 states, promoting open and non-discriminatory transmission access. Many TAPS members are entirely or predominantly transmission-dependent. States Pet. App. C-29. Unless otherwise noted or obvious all references herein are to States' Petition and Appendices.

[2] Contrary to Dalton's claim (Pet. 8), FERC based its order on a generic finding of *existing* undue discrimination in transmission services. *See* Enron Pet. App. D-192a, 213a, E-437a. Also, Dalton (Pet. 24) misreads *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973), as barring FERC from ordering transmission service to cure undue discrimination, a matter not reached in the Court's decision.

[3] TAPS responds to questions 1, 2 and 4 of the States' Petition.

[4] In a bundled retail sale transmission and electric energy are provided and sold together under one rate, and in an unbundled sale they are provided and sold separately. Pet. App. Q-3.

REASONS WHY THE STATES' PETITION SHOULD BE DENIED

I. PETITIONERS' FIRST POINT RESTS UPON A PREMISE REJECTED BY THIS COURT AND CONTRARY TO THE RECORD BELOW, AND SEEKS REVIEW OF AN ALTERNATIVE (AND SOUND) HOLDING

Petitioners States challenge the decision below because it affirms FERC's regulation of transmission used for unbundled retail electric sales, arguing that this is an impermissible regulation of "the transmission of electricity from a generator to a retail customer in the same state ...." Pet. 10. Their objection rests upon the discredited premise that a modern electric system directly transmits electrons "from a generator to a retail customer." *Id.* This is not how an integrated and interconnected electric transmission system works. The precedent of this Court and the decision and order below correctly find that power on an integrated and interconnected electric system "comes from a variety of sources" and is "commingled just as molecules of water from different sources (rains, streams, etc.) [are] commingled in a reservoir." *FPC v. Florida Power & Light Co.*, 404 U.S. 453, 461 (1972). This commingled power is energy transmitted "in interstate commerce" within the meaning of the Federal Power Act ("FPA") and thus transmission subject to FERC's jurisdiction.

The FPA authorizes FERC to regulate "the transmission of electric energy in interstate commerce." FPA § 201(a), 16 U.S.C. § 824(a) (1994). Based upon this language, as construed by this Court, the D.C. Circuit affirmed FERC's jurisdiction over the transmission component of unbundled retail sales. The decision properly found this Court to have held that FERC had plenary jurisdiction over the

transmission by nearly[5] "every privately owned interconnected [utility] in the United States ...." Pet. App. C-33 (quoting *FP&L*, 404 U.S. at 471 [Douglas, J., dissenting]).[6] *FP&L* is consistent with FERC's expert determination below: transmission used to support unbundled retail sales, like all transmission, is transmission of a commingled stream of electrons from multiple, including interstate, sources.[7] "Because of the highly integrated nature of the electric system, ... most transmission of electric energy [is] 'in interstate commerce.'" Pet. App. D-90.

There is no support in the decision or orders below (or otherwise) for the States' contention that there is direct transmission of electricity from a generator to a retail customer in the same state. At best, the States' jurisdictional challenge rests upon a fictional "contract path for a particular power or transmission sale ...." Pet. App. D-90. But as the decision and order below correctly recognize, this Court has held that federal jurisdiction follows the "engineering and scientific" flow of electricity, not fiction. Pet. App. D-91; *see also* Pet. App. C-31–33 (same).

Contrary to States' fourth question (Pet. i), the D.C. Circuit did not improperly defer to FERC's interpretation of its

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[5] There is intrastate transmission in Alaska, Hawaii and (arguably) portions of Texas because electric utility systems in these states are not interconnected (or interconnected only through direct current ties) with electric systems in other states. The States concede that FERC is not seeking to exercise jurisdiction over such transmission. Pet. 16 n.10. *See also* Pet. App. D-43 n. 541.

[6] The decision below strongly suggests that FERC could exercise jurisdiction over the transmission component of bundled retail electric sales, but as "a statutorily permissible policy choice" declined to do so. Pet. App. C-34.

[7] Contrary to States' assertion (Pet. 12), *FP&L* did involve federal preemption of state regulation. *FP&L* affirmed the Federal Power Commission's ("FPC") finding that Florida Power "must comply with all ... requirements of the Commission's Regulations under the [FPA]." *Florida Power & Light Co.*, 37 F.P.C. 544, 546 (1967), *aff'd*, 404 U.S. 453 (1972).

jurisdiction. As the States concede (Pet. 7), deference is an alternative holding reached only after the decision affirmed FERC's jurisdiction based on this Court's precedent construing the FPA. This alternative holding does not raise a question worthy of certiorari.

In any event, such deference is consistent with numerous decisions of this Court. *See, e.g., Massachusetts v. Morash*, 490 U.S. 107, 116-118 (1989); *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354, 380-81 (1988) (and cases cited therein). Seeking to rely upon *Hillsborough County v. Automated Medical Labs, Inc.*, 471 U.S. 707, 715 (1985), a decision not involving the FPA, the States argue that it is wrong to defer to FERC's interpretation of its jurisdiction because the FPA reserves certain powers to the states. However, in *MP&L*, decided subsequent to *Hillsborough*, Justice Scalia, writing in concurrence, explained that the *MP&L* Court did just that, *i.e.*, deferred to FERC's assertion of jurisdiction over purportedly state matters. *MP&L*, 487 U.S. at 380-81. Similarly, in *FP&L*, 404 U.S. at 463, the Court deferred to the FPC's "technical expertise and experience" in affirming federal jurisdiction over matters allegedly left to the states.

It is not clear there is a conflict between the decision below and *Northern States Power Co. v. FERC*, 176 F.3d 1090 (8th Cir. 1999), *cert. denied*, 120 S. Ct. 1221 (U.S. 2000). *NSP*, 176 F.3d at 1096, held only that FERC had "no jurisdiction ... over the state's regulation of NSP's bundled retail sales activities," based upon FERC's own jurisdictional "conce[ssion]." If States' reading of *NSP* were correct, that decision would be in conflict with the holding in *FPC v. Louisiana Power & Light Co.*, 406 U.S. 621, 636 (1972), that under the Natural Gas Act the FPC has authority over all interstate gas transportation, including transportation of bundled retail sales.

II. THE STATES' SECOND POINT RESTS UPON THE INVALID PREMISE THAT THE STATES CAN REGULATE WHOLESALE ELECTRIC POWER SALES

The States' argument that Order 888 improperly extends FERC jurisdiction to facilities used in local distribution of electric energy (Pet. 19-21) is equally misconceived. FPA section 201(b)(1) grants FERC jurisdiction over "all facilities" used by public utilities for the interstate transmission or wholesale sale of electric energy. The provision goes on to state that "except as specifically provided in this subchapter and subchapter III of this chapter," *i.e.*, Parts II and III of the FPA, FERC lacks jurisdiction "over facilities used in local distribution." As the D.C. Circuit correctly found, the FPA subordinates state jurisdiction over local distribution facilities to FERC jurisdiction over interstate transmission and sales at wholesale. Pet. App. C-37. Far from being an expansion of FERC jurisdiction, Order 888 confirms jurisdiction FERC and the FPC have for decades exercised over delivery over low-voltage power delivery facilities of wholesale sales of electric energy.

The necessary and faulty premise of States' position is that the states can regulate aspects of wholesale sales transported on low voltage distribution systems. States' position is irreconcilable with *Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83, 89 (1927), finding the states powerless to regulate wholesale electric sales, and an "unbroken chain" of wholesale (gas) transport. This unbroken wholesale delivery chain exists under the FPA and bars states from regulating the low voltage delivery component of wholesale sales. *See United States v. Pub. Utils. Comm'n*, 345 U.S. 295, 310-11, 316 (1953) (neither FPA § 201(a) nor the use of local distribution facilities in effecting a sale preserve State commission jurisdiction over sales for resale in interstate commerce). "FERC's assertion of jurisdiction over all wholesale transmissions, regardless of

the nature of the facility, is clearly within the scope of its statutory authority." Pet. App. C-37.

The States' reliance on *Connecticut Light & Power Co. v. FPC*, 324 U.S. 515 (1945) is misplaced because the Court did not find that the states could regulate the low voltage distribution component of wholesale sales by public utilities. *See Arkansas Power & Light Co. v. FPC*, 368 F.2d 376, 383 & n.8 (8th Cir. 1966). Contrary to States' claim (Pet. 20), *Wisconsin-Michigan Power Co. v. FPC*, 197 F.2d 472, 477 (7th Cir. 1952), held that low-voltage delivery facilities used to deliver wholesale transactions were not "local distribution facilities" exempt from FPC jurisdiction because "at no point before the delivery to [the wholesale customer] has been completed, [is] interstate transmission terminated." Also, contrary to States' petition (Pet. 20), the reasoning of *Duke Power Co. v. FPC*, 401 F.2d 930, 942 (D.C. Cir. 1968), is that Duke's low voltage facilities would have been FPC "jurisdictional facilities ... [if they were] engaged in the ... sale at wholesale of electric energy in interstate commerce," but they were not. *Id.* at 950.

CONCLUSION

For these reasons, the petitions for writ of certiorari of the States and Dalton should be denied.

Respectfully submitted,

Robert C. McDiarmid
Counsel of Record
Cynthia S. Bogorad
Ben Finkelstein
Peter J. Hopkins

(5)

No. 00-809

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

ENRON POWER MARKETING, INC.,

Petitioner,

—v.—

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE STATE PUBLIC SERVICE COMMISSIONS IN OPPOSITION

Lawrence G. Malone*
General Counsel
Jonathan D. Feinberg
Diane T. Dean
Assistant Counsel
NYS Public Service Commission
3 Empire State Plaza
Albany, New York 12223-1350
(518) 474-2510

* *Counsel of Record*

January 26, 2001

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QUESTIONS PRESENTED

1. Whether the District of Columbia Circuit correctly affirmed a Federal Energy Regulatory Commission (FERC) decision that it lacked jurisdiction under the Federal Power Act (FPA) subchapter 2, 16 U.S.C. §§ 824, *et seq.*, to regulate the transmission of electric energy "bundled" (*i.e.*, combined) with the retail sale of the electricity?*

2. Does the D.C. Circuit decision, which—unlike its confirmance of FERC's treatment of "unbundled" transmission—is consistent with 70 years of state/federal dual regulation of energy matters, raise a question warranting certiorari?

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* "Unbundling" permits competition for energy sales to retail customers by breaking ("unbundling") a monopoly rate for delivery of energy *and* energy into two rates; one for energy and the other for delivery.

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IN THE

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No. 00-809

ENRON POWER MARKETING, INC.,

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FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE STATE PUBLIC SERVICE COMMISSIONS IN OPPOSITION

STATEMENT OF THE CASE

A. Enactment Of The Federal Power Act

After electricity is generated, it is either: (i) transmitted and locally distributed to the ultimate consumer (a retail sale) or (ii) transmitted and sold to a reseller (a wholesale sale) who then transmits and distributes the power to the consumer (again, a "retail sale"). Retail electric service has historically been "bundled," that is, the utility has levied one rate for both the commodity and its delivery. State commissions have regulated, and

continue to regulate, all aspects of bundled retail transactions, including service issues.

In 1934, Congress passed the FPA. Its stated purpose was not to override state regulation, but to fill a jurisdictional gap created by a Supreme Court decision barring states from the regulation of rates for wholesale energy sold across state lines. *Public Utilities Comm'n of Rhode Island v. Attleboro Steam and Electric Co.*, 273 U.S. 83, 89 (1927). Because, in the absence of federal regulation, there would be no regulation of interstate sales, Congress filled this "*Attleboro* Gap" by empowering the FPC to regulate wholesale electricity rates. Hence, 201(a) provides that "federal regulation is to extend *only* to those matters which are *not* subject to regulation by the States" (emphasis added).

In closing the "*Attleboro* Gap," Congress preserved the states' jurisdiction over the intrastate retail transmission of electricity. In fact, the FPA expressly safeguarded state regulation by, among other things, prohibiting the FPC, now the FERC, from regulating (a) any aspect of the delivery of electricity from a generator to a retail consumer in the same state,[1] or (b) the use of local distribution facilities.[2]

B. FERC's Decision

In the decision under review, FERC, among other things, preempted the states' jurisdiction of the transmission of electricity from a power plant to a retail customer in the same state when states "unbundle" the commodity from delivery (presumably to implement retail competition). FERC, however, recognized traditional state control over bundled retail sales.

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[1] FPA §§ 201(a), (b)(1), (c) [16 U.S.C. §§ 824(a), (b) and (c)]; 212(h) [16 U.S.C. § 824k(h)].

[2] FPA § 201(b)(1) [16 U.S.C. § 824(b)(1)].

FERC observed that jurisdictional lines over bundled transactions were drawn on the basis of whether a transaction included either retail or wholesale sale of electric energy. Enron Appendix, "App." 304a, FERC Order 888 at 31,780. Thus, FERC adhered to the law with respect to bundled sales, concluding "that when transmission is sold at retail as part and parcel of the delivered product called electric energy, the transaction is a sale of electric energy at retail." Enron App. 306a, FERC Order 888 at 31,781. It adhered to its position on rehearing. Enron App. 455a, FERC Order 888A at 30,225-226.

C. The D.C. Circuit's Decision

On June 30, 2000, a Panel of the D.C. Circuit upheld both aspects of FERC's decision with respect to its jurisdiction over transmission. In upholding FERC's preemption of state regulation of retail transmission, the D.C. Circuit concluded that FERC had jurisdiction over transmission services if a state chose to unbundle retail rates.

The Court concluded, however, that FERC was not required to mandate unbundling and assert jurisdiction over all retail transmissions. It decided that "[a] regulator could reasonably construe transmissions bundled with generation and delivery services and sold to a consumer for a single charge as either transmission services in interstate commerce or as an integral component of a retail sale." Enron App. 35a. It concluded that "FERC's decision to characterize bundled transmissions as part of retail sales subject to state jurisdiction therefore represents a statutorily permissible policy choice to which we must also defer under *Chevron*." Enron App. 35a.[3]

---

[3] The states have petitioned for certiorari from the decision to uphold FERC power over unbundled retail transmission. The strain Enron observes in the D.C. Circuit decision (Enron at 12) was most

REASONS FOR DENYING THE PETITION

Enron's petition for certiorari raises a question resembling that involved in *Northern States Power Co. v. Federal Energy Regulatory Comm'n*, 176 F.3d 1090, 1096 (8th Cir. 1999), *rehearing denied*, 1999 U.S. App. Lexis 23493 (8th Cir. 1999), *cert. denied*, 120 S.Ct. 1221, ___ U.S. ___ (2000). [FPA does not allow FERC to curtail electrical transmission to retail customers.] The D.C. Circuit should have upheld FERC's decision not to preempt the states' longstanding regulation of bundled transmission because there is no indication that Congress intended to preempt state regulation. *Hillsborough County, Florida v. Automated Medical Laboratories*, 471 U.S. 707, 715 (1985) ["Where . . . the field that Congress is said to have pre-empted has been traditionally occupied by the States 'we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.' "] *Solid Waste Agency of Northern Cook County v. United States Army Corps of Engineers*, ___ U.S. ___, 69 U.S.L.W. 4048, 4051 2001 U.S. LEXIS 640 (January 9, 2001) [not applying *Chevron* in concluding Army Corps of Engineers does not have authority over isolated ponds, some only seasonal, under 404(a) of the Clean Water Act]. The D.C. Circuit nonetheless reached the correct result—an affirmance of FERC's decision—by applying the deferential standard of *Chevron U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984).

Enron argues, however, that FERC has control over all "transmission of electric energy in interstate commerce,"

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likely due to that court's need to distinguish its "incorrect" conclusion regarding unbundled retail transmission from its correct conclusion regarding bundled retail transmission.

including transmission as part of bundled retail sales (Enron at 10-11). Enron's position amounts to a claim that FERC, and its predecessor, the FPC, have misread the FPA for more than 65 years. In other words, Enron has asked the Supreme Court to apply an interpretation of the Federal Power Act that neither FERC nor its predecessor has ever applied and that would depart from historical federal-state jurisdiction "by permitting federal encroachment on a traditional state power." *Solid Waste Agency of Northern Cook County v. United States Army Corps of Engineers*, 69 U.S.L.W. at 4051, 2001 U.S. Lexis 640 *23-24.

Enron relies upon the D.C. Circuit's incorrect conclusion that FERC has jurisdiction over unbundled retail transmission. That decision is in error, both because the D.C. Circuit applied the wrong standard, and because Section 201(c) of the FPA specifically defines the transmission of electric energy in interstate commerce as being transmitted from one state and consumed in another.[4]

In any event, the D.C. Circuit got the result right on transmission bundled with retail sales. Under the FPA, FERC may regulate only those matters that cannot be regulated by the states. FPA 201(a), [16 U.S.C. § 824(a)]. States have always set rates for, and controlled the terms and conditions of, transmission service when bundled with retail electric rates. Congress has directed that bundled retail transactions remain state jurisdictional. *Federal Power Comm'n v. Southern California Edison Co.*, 376 U.S. 205, 212-15 (1964) [There is a "bright line" between state power over retail sales and federal power

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[4] That section provides that "electric energy shall be held to be transmitted in interstate commerce if transmitted from a state and consumed at any point outside thereof."

over wholesale sales]. The transactions at issue, the transmission of energy that is part of a bundled retail sale, are retail. *See General Motors Corporation v. Tracy*, 519 U.S. 278, 294 (1997) [state can distinguish between bundled utility service and unbundled supply of gas in levying taxes]. Enron fails to acknowledge that under FPA § 212(h) the decision whether even to allow the competitive transmission of energy to a retail customer lies with the states, not with FERC.[5] Enron's attempt to rely on case law under the Natural Gas Act for the proposition that FERC, not the states, must regulate the transmission component of a bundled retail sale is misplaced. The Natural Gas Act cases cited by Enron address the question, not present here, of the regulation of the interstate transport of gas (*i.e.*, gas was produced in one state and consumed in a second state). That regulation was considered "practically beyond the competence of state regulatory agencies." *Federal Power Comm'n v. Louisiana Power & Light*, 406 U.S. 621, 641 (1972). Compare, FPA § 201(c) [interstate transmission involves electricity "transmitted from a state and consumed at any point outside thereof."]

Enron's further argument that FERC must exercise its alleged jurisdiction over all transmission to protect competitive electric providers fails because (1) FERC simply does not have jurisdiction to address discrimination in the provision of bundled retail service, and (2) the hindrances to competition that Enron alleges have not been shown to exist, but even if they did, they create no basis for restricting state power over retail rates; and (3) alleged problems with a statutory grant provide no reason to ignore the will of Congress and change the grant. *Louisiana Public Service Comm'n v.*

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[5] That section provides that "[n]o order issued under this chapter shall be conditioned upon or require the transmission of electric energy: (1) directly to an ultimate consumer. . . ."

Federal Communications Comm'n, 476 U.S. 355, 376 (1986) ["As we so often admonish, only Congress can rewrite this statute"]. In any event, FERC can still address discrimination in the provision of wholesale services (assuming such discrimination exists) by either lowering wholesale rates or requiring increased transmission capability.

POINT I

THE D.C. CIRCUIT WAS CORRECT IN CONFIRMING FERC'S HOLDING THAT THE FEDERAL POWER ACT LEFT THE STATES JURISDICTION OF TRANSMISSION IN A BUNDLED RETAIL SALE

1. The Federal Power Act Safeguards State Jurisdiction Over All Intrastate Retail Transactions, Particularly Bundled Retail Transactions, By Creating A "Bright Line" Between Wholesale/Retail Transactions. Enron claims that the Federal Power Act on its face gives FERC control over all transmission in interstate commerce, whether wholesale or retail, bundled or unbundled (Enron 13). The statute on its face only gives FERC control over the "transmission of electric energy in interstate commerce," which FPA § 201(c), [16 U.S.C. § 824(c)], defines as energy "transmitted from a State and consumed at any point outside thereof." The statute thus applies only to transmission transactions occurring between states.

The D.C. Circuit has, contrary to the language of the statute, decided that all *unbundled* transmission on an electric grid connected to other states, even transmission from generators to customers in the same state, is transmission in interstate commerce. Enron App. 34a. Enron cites the decision of the D.C. Circuit on unbundled trans-

mission to the effect that where utilities interconnect, inevitably "some" energy is transmitted across state lines. *Id.* However, the transport of *some* energy across state lines does not mean *all* energy is subject to federal regulation.[6]

In any event, the D.C. Circuit properly decided the FPA does not give FERC control over transmission when *bundled* with retail sales of energy. The statute specifically deprives FERC of jurisdiction over "any other sale of electric energy. . . ." FPA § 201(b) [16 U.S.C. § 824(b)]. Enron's argument for jurisdiction over transmission incident to bundled sales ignores the FPA's overarching goal, which is to delineate state and federal jurisdiction and preserve state jurisdiction by limiting federal regulation "to those matters which are not subject to the States." FPA § 201(a) [16 U.S.C. § 824(a)].

This Court has emphasized that the purpose of the FPA was to "adopt the test developed in the *Attleboro* line which "denied state power to regulate a sale 'at *wholesale* to local distributing companies' and allowed state regulation of a sale 'at local *retail* rates to ultimate consumers.' " [emphasis added; citation omitted]. *FPC v. Southern Cal. Edison Co.*, 376 U.S. at 214. *United States v. Public Utilities Comm'n of California*, 345 U.S. 295, 308 (1953) ["Congress interpreted [*Attleboro*] as prohibiting state control of wholesale rates in interstate

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[6] Enron relies upon *Federal Power Comm'n v. Florida Power & Light Co.*, 404 U.S. 453, 463 (1972) to support FERC jurisdiction over all transmission on an interconnected grid, but that case just upheld FPC jurisdiction over utility books and records, not over all transmission on a utility system, and especially not bundled retail transmission. *FPC v. Southern California Edison*, also cited by Enron, supports FERC jurisdiction over wholesale sales and service in interstate commerce, but specifically states Congress meant to draw a "bright line easily ascertained, between state and federal jurisdiction . . . ." 376 U.S. at 215-16.

commerce for resale, and so armed the Federal Power Commission with precisely that power."]. In giving the FPA power over matters the states could not regulate, Congress protected the states' power over matters they could regulate. *FPC v. Southern Cal. Edison Co.*, 376 U.S. at 215-16.

Enron relies (at 13) upon a statement by the D.C. Circuit that FPA §§ 201(a) and (b) confer on FERC jurisdiction over the transmission of electric energy in interstate commerce. As the D.C. Circuit held, however, Congress' preservation of retail sales jurisdiction also preserves the states' jurisdiction (§ 201(a)) over transmission bundled with retail sales. Enron App. 35a. Bundled retail sales by definition include the transmission associated with such sales. *Northern States Power Co. v. Federal Energy Regulatory Comm'n*, 176 F.3d 1090, 1096 (8th Cir. 1999), *rehearing denied*, 1999 U.S. App. LEXIS 23493 (8th Cir. 1999), *cert. denied*, 120 S. Ct. 1221, ___ U.S. ___ (2000) [wherein the Eighth Circuit found that FERC's "attempt to regulate the curtailment of electrical transmission on native/retail consumers is unlawful, as it falls outside of the FPA's specific grant of authority to FERC."].

Finally, Enron's claim that the D.C. Circuit should have held FERC has jurisdiction over transmission incidental to bundled retail sales flies in the face of the Energy Policy Act of 1992 (EPAct), which precludes FERC from ordering retail wheeling. FPA § 212(h) [16 U.S.C. § 824k(h)], reserves to the states the decision whether to even allow transmission directly to retail customers.[7] Thus, while the statute clarified FERC's authority to order utilities to provide transmission service, it also "prohibited FERC from

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[7] Indeed, the D.C. Circuit was incorrect in speculating that FERC might conceivably have jurisdiction to mandate unbundling (Enron App. 35a), because § 212(h) denies FERC any authority to require any unbundling of retail transactions.

forcing utilities to engage in 'retail wheeling,' the transmission of power directly to a retail customer." House Comm. on Energy and Commerce, Energy Policy Act of 1992, P.L. 102-486, House Report No. 102-474(I) at 140 (1992), *reprinted in* 1992 U.S.C.C. A.N. 1953, 1963.

Enron complains (at 16) that the D.C. Circuit's decision to uphold FERC's interpretation of § 201(b) would make its jurisdiction contingent on whether the utility selects bundled or unbundled pricing. The decision to provide unbundled retail service is made by state regulators under § 212(h) [16 U.S.C. § 824k(h)], which provides in pertinent part, that "[n]o order issued under this chapter shall be conditioned upon or require the transmission of electric energy: (1) directly to an ultimate consumer, or (2) to, or for the benefit of an entity if such electric energy would be sold by such entity directly to an ultimate consumer . . . ."[8] Therefore, FERC cannot require transmission to an ultimate consumer.

2. Precedent From The Natural Gas Act Does Not Support FERC Jurisdiction Over Bundled Retail Transmission. Enron relies on case law involving interstate transmission of natural gas. *Federal Power Comm'n v. Louisiana Power & Light Co.*, 406 U.S. 621 (1972). *Mississippi River Transmission Corp. v. Federal Energy Regulatory Comm'n*, 969 F.2d 1215 (D.C. Cir. 1992). In *Federal Power Comm'n v. Louisiana Power & Light Co.*, this Court held the FPC could curtail interstate transportation of natural gas to industrial customers, although the transportation was occurring in association with nonjurisdictional direct sales of natural gas to those customers and the FPC lacked rate setting authority with respect to those customers. 406 U.S. at 640-41. The hold-

[8] Section 212(h) finally provides that "[n]othing in this subsection shall affect any authority of any State or local government under State law concerning the transmission of electric energy directly to an ultimate consumer."

ing does not support Enron's position because the Court did not conclude that FERC acquired jurisdiction over the transportation component of a sale to a retail customer.[9]

Enron also relies on the distinction in *FPC v. Louisiana Power & Light* between the FPC's jurisdiction over transportation of natural gas and its jurisdiction over gas sales, and the Court's consequent statement that the Act applies to the interstate transportation of gas regardless of its ultimate disposition (Enron at 15, citing 406 U.S. at 636). This claim, like many of Enron's arguments, begs the question of whether a transaction is an interstate one subject to federal power or a retail intrastate one subject to state jurisdiction. It is well-established that the states retain jurisdiction over retail sales of gas, including control over the bundled sale of gas. *General Motors Corporation v. Tracy*, 519 U.S. 278, 301-302 (1997).

Enron's further reliance on *FPC v. Louisiana Power & Light* for the proposition that FERC must be able to prevent discrimination in favor of retail customers (at 20-21) is misplaced because Enron seeks to obtain a result the Court rejected in *FPC v. Louisiana Power & Light*. The concern in *FPC v. Louisiana Power & Light* was that if FERC had no jurisdiction over curtailment of gas for direct sales, then interruptible and direct customers

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[9] Of critical importance to this Court's decision in *FPC v. Louisiana Power & Light* was that "[c]omprehensive and equitable curtailment plans for gas transported in interstate commerce . . . are practically beyond the competence of state regulatory agencies." 406 U.S. at 641. The impracticality of state regulation of interstate gas transportation arose because of the "unavoidable conflict between producing and consuming states. . . ." 406 U.S. at 633-634. Natural gas fields are centralized in certain states and a network of interstate pipelines deliver the product to local distribution companies regulated by state commissions. In contrast, unlike centralized natural gas collection and transportation, electricity can usually be supplied by generators located near the customer base.

would not be curtailed, while resale customers would be a result the Court rejected, noting that industrial customers would demand contract volumes "while homes, hospitals and schools suffer from lack of adequate service." 406 U.S. at 632. Here, Enron seeks to compel such curtailment of retail customers in favor of its own usage of the transmission system by calling protection of retail customers "discrimination." Enron at 17-19.

Mississippi River Transmission Corp. v. FERC similarly involved interstate transportation combined with a direct sale, not gas sold to a local distribution company for sale to an ultimate consumer. Enron relies heavily (at 16) on language from the D.C. Circuit opinion in *Mississippi River Transmission Corp.* that FERC sought to regulate the transmission component of a bundled direct sale service. The transportation in that case was occurring between states[10] and therefore could not be practically regulated by the states, as the D.C. Circuit recognized. 969 F.2d at 1218. In contrast to both *FPC v. Louisiana Power & Light* and *Mississippi River Transmission Corp. v. FERC*, Enron seeks to obtain FERC jurisdiction over the transmission component of a bundled retail sale that can effectively be regulated by state regulators—indeed, that has been so regulated since before the passage of the Federal Power Act.

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[10] Mississippi River Transmission Corporation transported "natural gas from wellheads in Texas, Oklahoma and Louisiana to customers in Missouri, Illinois, Arkansas and Louisiana." 969 F.2d at 1216-17.

POINT II

ENRON'S CLAIM THAT FERC JURISDICTION IS REQUIRED TO PREVENT DISCRIMINATION BY OWNERS OF INTERSTATE TRANSMISSION FACILITIES DOES NOT MERIT THIS COURT'S REVIEW BECAUSE, AMONG OTHER THINGS, THE D.C. CIRCUIT'S DECISION DOES NOT DISCOUNT FERC'S (OR THE STATES') ABILITY TO ADDRESS DISCRIMINATION

Enron alleges that FERC's lack of jurisdiction over electric transmission incident to bundled retail sales will allow transmission owners to discriminate in favor of their own unbundled retail sales, and that it therefore presents a legal question of the greatest practical importance (*see*, for instance, Enron 19-20). FERC was under no duty to remedy discrimination in the provision of bundled retail electric sales because it has no jurisdiction over those transactions. As this Court stated in *Federal Power Comm'n v. Conway Corp.*, 426 U.S. 271, 276 (1976), FPA § 206(a) only allows FERC to remedy discrimination it finds to have been committed "by any public utility for any transmission or sale *subject to the jurisdiction* of the Commission" (emphasis added). FPA § 206(a), 16 U.S.C. § 824e(a).[11]

In any event, Enron's position is factually incorrect. It constitutes, in effect, a policy argument that the nation would be better off if the FPA allowed FERC jurisdiction over all transmission. Congress has, however, decided that the states are to protect retail customers.

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[11] This Court similarly described the history of § 205 (FERC's rate setting powers) as being "expressly limited to jurisdictional sales to foreclose the possibility that the Commission would seek to correct an alleged discriminatory relationship between wholesale and retail rates by raising or otherwise regulating the nonjurisdictional, retail price." *FPC v. Conway Corp.*, 426 U.S. at 277.

1. Congress Has Made A Policy Decision That The Nation Is Better Off If The States Are Responsible For Protecting The Interests Of Retail Customers. Enron argues (at 17-18) that Congress has in the Energy Policy Act (EPAct) emphasized the importance of interstate competition for supplying energy needs. It fails to acknowledge, however, that Congress was acting to encourage *wholesale* competition.[12] The history of EPAct, as well as that statute's plain language, shows Congress left to the states the question of whether there would be retail competition when it enacted FPA Section 212(h), 16 U.S.C. § 824k(h). Contrary to statements in Enron's brief (*see* Enron note 8), Congress made it clear in FPA 212(h), quoted at p. 10, *infra*, that FERC does not have jurisdiction to require retail competition.

Enron argues that there is an important question as to whether FERC must regulate the transmission component of a bundled rate, because otherwise a regulatory void will result, citing this Court's decision in *FPC v. Louisiana Power & Light* (at Enron 20-21) and *Federal Power Comm'n v. Transcon Gas Pipeline Corp.*, 365 U.S. 1, 28 (1961) (at Enron 21-22). An alleged "*need* for federal regulation does not establish FPC jurisdiction that Congress has not granted." *FPC v. Louisiana Power & Light Co.*, 406 U.S. at 635-36. Enron's position, moreover, is misplaced because the alternative to federal regulation of the transmission component of bundled retail sales is state regulation, not nonregulation. Inasmuch as

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[12] The legislative history of the Energy Policy Act of 1992 states that "[t]he bill's electricity provisions will promote additional competition in *wholesale* electricity power market in order to improve the efficiency of the electric utility industry and secure the lowest possible costs for consumers" (emphasis added). House Comm. on Energy and Commerce, Energy Policy Act of 1992, P.L. 102-486, House Report No. 102-474(I) at 138 (1992), *reprinted in* 1992 U.S.C.C. A.N. 1953, 1961.

state regulation *is* possible, the policy behind the federal statutes is to defer to state regulation of retail rates. *FPC v. Transcon Gas Pipeline*, 365 U.S. at 19 ["[t]hat is to say, in a borderline case where congressional authority is not explicit we must ask whether state authority can practicably regulate a given area . . ."].

The Eighth Circuit has recently addressed the need to protect retail customers when existing transmission lines are overloaded. *Northern States Power Co. v. FERC*, 176 F.3d at 1095. ["As indicated, when the circumstances require curtailment in the transmission of electricity, most wholesale customers may use alternative supplies from other utilities who generate power themselves, and can avoid power outages through such practices. The native/retail consumer, however, is unable to turn to alternative sources of supply"]. Under Enron's reading of the FPA, retail customers would lose service so that utilities could transport power from competitive wholesalers, a completely catastrophic result.

2. In Any Event, Enron's Claims of Discrimination Do Not Create An Important Question Because Enron Ignores The Reality That FERC Can Address Any Problems Arising From Supposed Wholesale Discrimination, While Problems With Retail Rates Have Been Left To The States. FERC can address Enron's claims that transmission owning utilities would be free to charge more than they themselves pay for a comparable service (Enron 19, 20). Thus, for instance, FERC has jurisdiction to avoid a "price squeeze" by lowering wholesale sales or transmission rates in order to prevent competitors from being charged a noncompetitive rate. *FPC v. Conway Corp.*, 426 U.S. at 278-79.[13]

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[13] A price squeeze can occur when a vertically integrated firm operates at two levels of an industry, and its competitors at one level (for instance, the retail level) are its customers at another (for

FERC did, moreover, act to preclude any discrimination in wholesale transmission service in its Order 888. FERC has precluded discrimination in wholesale services by requiring utilities to provide any transmission capacity, above the amount reserved for retail consumers, to competitors on a nondiscriminatory basis.[14] Under the FERC open access tariff, moreover, a "Transmission Provider will be obligated to expand or upgrade its Transmission System" where necessary, though the "Transmission Customer must agree to compensate the Transmission Provider for any necessary transmission facility additions. . . ." Pro Forma Open Access Transmission Tariff, Appendix D to FERC Order 888, ¶ 13.5[15].

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instance, the wholesale level). *Town of Concord, Mass. v. Boston Edison Co.*, 915 F.2d 17 (1st Cir. 1990), *cert. denied*, 499 U.S. 931 (1991). The price squeeze arises when a monopolist at the wholesale level sets the wholesale price too high and the retail price too low, denying its competitors a "living profit," because they cannot buy the service at a wholesale price low enough to resell at a retail price high enough to cover costs. This pricing deadlock "squeezes" the competitors out of the market, allowing the wholesale monopolist to become a retail level monopolist. *United States v. Aluminum Co. of America*, 148 F.2d 416, 437 (2d Cir. 1945) (*Alcoa*).

[14] This "available transmission capacity" (ATC) is to be provided to utility competitors making sales for resale at the same prices and terms at which utilities use that capacity themselves. FERC Order 888 at 31,700, Enron App. at 237a; FERC Order 888-A at 30,217, Enron App. 452a. Such provision of ATC is a full implementation of FERC responsibilities to preclude discrimination under FPA §§ 205 and 206.

[15] A state or its subdivisions would decide where a transmission line could be sited, consistent with state or local environmental or property laws. See FPA § 211(d)(1)(C)[16 U.S.C. § 824j(d)(1)(C)] [order directing transmission service terminated where transmitting utility "has failed, after making a good faith effort, to obtain the necessary approvals or property rights under applicable Federal, State and local laws."]. *Dunk v. Pennsylvania Public Utility Comm'n*, 434 Pa. 41, 252 A.2d 589 (1969), *cert. denied*, 396 U.S. 839 (1969) [FPA does not give FERC jurisdiction over construction of electric facilities.].

Such reinforcement of the transmission system for a price paid by the transmission customer is a far better recourse than that apparently sought by Enron, which would require curtailment of retail customers as a result of insufficient capacity on the transmission system.[16]

Enron contends (at 21) that the bifurcation of transmission into bundled and unbundled uses will allow a transmission owner to reserve a portion of the interstate grid "at no charge" for its retail load and then divert power into the competitive wholesale market. This argument misstates the operation of FERC's open access procedures, which do not permit reservation of capacity not needed for retail load.[17] Further, when a utility reserves and schedules transmission capacity on its portion of the interstate grid, it does not do so at "no charge." Rather, it forgoes revenue from wholesale customers as a result of its incorrect scheduling. The utility is not likely to recover that lost income in the short-term market by releasing the reserved capacity at the last moment.

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[16] This possibility of reinforcement fully addresses Enron's hypothetical about a state blocking interstate transmission by keeping retail sales bundled (Enron 20, n. 8). Utilities in that state can be required to provide additional transmission capacity for competitive providers. In any event, Congress has in § 212(h) of the FPA left the decision whether to have retail competition to the states.

[17] FERC limited the ability of utilities to reserve transmission capacity for native load. It stated:

> The transmission provider may reserve in its calculation of ATC transmission capacity necessary to accommodate native load growth *reasonably* forecasted in its planning horizon. However, the transmission provider is obligated to provide transmission service to others under the Final Rule pro forma tariff out of capacity reserved for native load growth up to the time the capacity is actually needed for such future needs (emphasis added).

FERC Order 888 at 31,765, Enron App. at 267a.

Finally, the states have power to address any discrimination that increases rates to retail customers. Enron asserts (at 20) that states have no authority to regulate interstate transmissions under the Commerce Clause, relying on *Public Utilities Comm'n v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927). That case, however, is one of a line of cases that *allow* state regulation of retail sales. 273 U.S. at 88 [citing *Pennsylvania Gas Co. v. Public Serv. Comm'n, Second District of the State of New York*, 252 U.S. 23 (1920); *Public Utilities Comm'n v. Landon*, 249 U.S. 236 (1919)].[18] A utility attempting to increase rates for retail customers by reserving excess transmission capacity would probably see state regulators impute the revenues lost due to improper scheduling. *See Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 972 (1986) ["Without deciding this issue, we may assume that a particular *quantity* of power provided by a utility from a particular source could be deemed unreasonably excessive [by a state commission] if lower cost power is available elsewhere . . ."]; *Rochester Gas and Electric Corporation v. Public Service Comm'n of the State of New York*, 754 F.2d 99 (2d Cir. 1985) [upholding NYPSC imputation of incidental sales from wholesale revenues]. Thus, a utility has an incentive to accurately reserve capacity.

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[18] Further, the Commerce Clause limitations created by *Attleboro* have been eroded and *Attleboro* is now no longer good Constitutional law. *Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375 (1983). *Attleboro* only has validity to the extent it is used as a guide to FPA construction.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

Lawrence G. Malone
General Counsel
NYS Public Service Commission
Three Empire State Plaza
Albany, New York 12223-1350
(518) 474-2510

Dated: January 26, 2001
Albany, NY

James Bradford Ramsay
General Counsel
Sharla M. Barklind
Associate General Counsel
National Association of
Regulatory Utility Commissioners
1101 Vermont Ave., N.W.
Suite 200
Washington, D.C. 20005
(202) 898-2208

Catherine D. Bedell
General Counsel
Richard Bellak
Associate General Counsel
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850
(850) 413-6092

Alan G. Lance
Attorney General
Donald L. Howell, II
Deputy Attorney General
Idaho Public Utilities Commission
472 W. Washington Street
P.O. Box 83720
Boise, Idaho 83720-0074
(208) 334-0312

John J. Farmer, Jr.
Attorney General
State of New Jersey
Helene S. Wallenstein
Sr. Deputy Attorney General
Attorney for New Jersey Board of Public Utilities
124 Halsey Street, 5th Floor
P.O. Box 45029
Newark, New Jersey 07101
(973) 648-4846

Jo Anne Sanford
North Carolina Utilities Comm'n
Robert P. Gruber
Public Staff – North Carolina Utilities Comm'n
Gisele L. Rankin
Staff Attorney
P.O. Box 29520
Raleigh, North Carolina 27626-0520
(919) 733-2435

William H. Chambliss
General Counsel
C. Meade Browder, Jr.
Attorney
Virginia State Corporation Comm'n
Office of General Counsel
P.O. Box 1197
Richmond, Virginia 23218
(804) 371-9671

Christine O. Gregoire
Attorney General
William Berggren Collins
Sr. Assistant Attorney General
Robert D. Cedarbaum
Senior Counsel (for the Washington Utilities and Transportation Commission)
P.O. Box 40128
Olympia, Washington 98504-0128
(360) 664-1188

Harvey L. Reiter
(for the Vermont Department of Public Service)
Morrison & Hecker
1150 18th Street, N.W.
Suite 800
Washington, D.C. 20036
(202) 785-9100

Harry Ivey
(for the Wyoming Public Service Commission)
Attorney General's Office
State of Wyoming
123 Capitol
Cheyenne, Wyoming 82002
(307) 777-7824

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Nos. 00-568, 00-800 and 00-809

In the Supreme Court of the United States

STATE OF NEW YORK, ET AL., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

BOARD OF WATER, LIGHT AND SINKING FUND COMMISSIONERS OF THE CITY OF DALTON, GEORGIA, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION

ENRON POWER MARKETING, INC., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

DOUGLAS W. SMITH
General Counsel
CYNTHIA A. MARLETTE
Deputy General Counsel
SUSAN J. COURT
Associate Solicitor
TIMM L. ABENDROTH
Attorney
Federal Energy Regulatory Commission
Washington, D.C. 20426

BARBARA D. UNDERWOOD
Acting Solicitor General
Counsel of Record
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

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QUESTIONS PRESENTED

In its Order No. 888 rulemaking, the Federal Energy Regulatory Commission found that public utilities subject to its jurisdiction under the Federal Power Act (FPA), 16 U.S.C. 792 *et seq.*, discriminated unlawfully in providing access to their electric transmission facilities. As a remedy, Order No. 888 requires them to unbundle their packaged wholesale electric energy service into separate energy sales and transmission services and to provide non-discriminatory access to their electric transmission systems in order to ensure "open access" to the interstate energy transmission grid and thereby facilitate competition in the national market for electric energy. The questions presented are:

1. Whether the Commission's open access regulations are permissible under Sections 205 and 206 of the FPA, 16 U.S.C. 824d and 824e.

2. Whether the Commission properly concluded that Section 201 of the FPA, 16 U.S.C. 824, authorizes the Commission to assert jurisdiction over interstate transmission service involved in a retail sale transaction where States have unbundled such transactions into separate transmission and sales services, but does not require the Commission to assert jurisdiction over transmission service that remains bundled with local retail sales and distribution service.

3. Whether Section 201 of the FPA authorizes the Commission to assert jurisdiction over facilities that may be used both for local distribution to retail customers and for transmission of electric energy to wholesale purchasers.

4. Whether Section 201 of the FPA bars the Commission from allowing utilities to recover certain stranded costs caused by the unbundling of retail electric service.

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In the Supreme Court of the United States

No. 00-568

STATE OF NEW YORK, ET AL., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

No. 00-800

BOARD OF WATER, LIGHT AND SINKING FUND COMMISSIONERS OF THE CITY OF DALTON, GEORGIA, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION

No. 00-809

ENRON POWER MARKETING, INC., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. C1-C121)[1] is reported at 225 F.3d 667. The relevant orders of the Federal Energy Regulatory Commission are reported as follows: Order No. 888, F.E.R.C. Stats. & Regs., Regulations Preambles January 1991-June 1996, ¶ 31,036; Order No. 888-A, 3 F.E.R.C. Stats. & Regs. ¶ 31,048; Order No. 888-B, 81 F.E.R.C. ¶ 61,248. Relevant portions of those orders are reprinted in Pet. App. D1-D125, E1-E120, and F1-F21; 00-809 Pet. App. 125a-369a, 371a-551a; 00-800 Pet. App. 1a-111a.

JURISDICTION

The judgment of the court of appeals (Pet. App. B1-B2) was entered on June 30, 2000. A petition for rehearing was denied on August 22, 2000 (Pet. App. A1-A2). The petition for a writ of certiorari in No. 00-568 was filed on October 12, 2000. The petitions in Nos. 00-800 and 00-809 were filed on November 20, 2000. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Part II of the Federal Power Act (FPA or the Act), 16 U.S.C. 824-824m, confers on the Federal Energy Regulatory Commission (FERC or the Commission) jurisdiction over rates, terms, and conditions of electric transmission service provided by public utilities in interstate commerce.[2] Section 201(b)(1) of the FPA

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[1] Unless otherwise indicated, references to "Pet. App." are to the appendix to the certiorari petition in No. 00-568.

[2] Section 201(e), 16 U.S.C. 824(e), defines "public utility" as "any person who owns or operates facilities subject to the jurisdiction of the Commission." Section 201(f), 16 U.S.C. 824(f), excludes from FERC's jurisdiction companies owned by "the

authorizes the Commission to exercise jurisdiction over "the transmission of electric energy in interstate commerce," "the sale of electric energy at wholesale in interstate commerce," and "all facilities for such transmission or sale of electric energy." 16 U.S.C. 824(b)(1). Jurisdiction over "facilities used in local distribution or only for the transmission of electric energy in intrastate commerce" is left to the States. *Ibid.* Section 201(c) further provides that electric energy is transmitted in interstate commerce if it is "transmitted from a State and consumed at any point outside thereof." 16 U.S.C. 824(c).

Pursuant to Section 205(c) of the FPA, 16 U.S.C. 824d(c), public utilities subject to FERC's jurisdiction must file tariff schedules with FERC showing their rates and service terms, along with related contracts for jurisdictional service. Section 205(b) of the Act prohibits such utilities from "grant[ing] any undue preference or advantage to any person or subject[ing] any person to any undue prejudice or disadvantage." 16 U.S.C. 824d(b). Whenever the Commission finds that any rate charged by any such utility "for any transmission or sale," or that any utility's practice "affect[ing] such rate" is "unjust, unreasonable, unduly discriminatory or preferential," Section 206 of the Act directs FERC to prescribe a lawful rate or practice for the future. 16 U.S.C. 824e.

2. In recent years, the electric utility industry has evolved from a traditional, heavily regulated industry dominated by vertically integrated monopolies into a more competitive industry in which customers have choices as to their power suppliers. Pet. App. C8-C10.

United States, a State or any political subdivision of a State," except as specifically provided.

A key impediment to developing a competitive wholesale market for electric power is the monopoly ownership of interstate transmission systems: a utility that controls access to transmission services can deny market access to competitors and favor its own generation in competing for buyers. *Id.* at C10. In Order No. 888, the Commission found, based on an extensive rulemaking record, that public utilities were denying or providing inferior access by others to their transmission service, in violation of the nondiscrimination provisions of Sections 205 and 206 of the Act. 00-809 Pet. App. 213a-218a.

As a remedy, Order No. 888 requires public utilities that own or control transmission facilities to offer transmission service to customers on terms comparable to the transmission service they use in serving their own power customers. Order No. 888 also prescribes certain minimum terms and conditions of service necessary to provide nondiscriminatory open-access service and requires utilities to file tariffs setting out those terms and conditions. Pet. App. C10-C11, D9. The Order further requires the unbundling of electric utilities' wholesale electricity product into separately priced sales and transmission services, and requires utilities to take transmission service for their own wholesale sales and purchases under the same open access tariff applicable to others. 00-809 Pet. App. 178a.

During the course of its rulemaking, the Commission addressed several issues concerning its jurisdiction over transmission of electric energy in light of the Act's provisions giving the States jurisdiction over local distribution and retail sales of electric energy. Among those issues was whether federal authority extended to the interstate transmission component of a public utility's sale of power to its retail customers. As the

Commission recognized, a growing number of States have permitted or required utilities that provide retail service to unbundle their services so that customers can purchase power from sources other than their historical suppliers. Pet. App. D7. Such unbundling, in turn, required the Commission to determine which transmission facilities and services would be subject to the nondiscriminatory tariffs of Order No. 888. The Commission resolved that jurisdictional question as follows:

> [W]e believe that when transmission is sold at retail as part and parcel of the delivered product called electric energy, the transaction is a sale of electric energy at retail. Under the FPA, the Commission's jurisdiction over sales of electric energy extends only to wholesale sales. However, when a retail transaction is broken into two products that are sold separately (perhaps by two different suppliers: an electric energy supplier and a transmission supplier), we believe the jurisdictional lines change. In this situation, the state clearly retains jurisdiction over the sale of the power. However, the unbundled transmission service involves *only* the provision of "transmission in interstate commerce" which, under the FPA, is exclusively within the jurisdiction of the Commission.

Id. at D44 (emphasis added). Given FERC's jurisdiction over unbundled transmission, the agency further distinguished between wholesale and retail transactions. In the wholesale situation, FERC asserted exclusive jurisdiction over the rates, terms, and conditions of all unbundled transmission service and the facilities used to provide the transmission, regardless of whether those facilities are labeled "transmission," "distribution" or "local distribution." *Id.* at D43-D44, D122, F8.

Order No. 888 thus requires public utilities offering such transmission to file transmission rate schedules with FERC that comply with its open-access rule, and provides that a share of the cost of transmission assets previously included in retail rate base will now be included in rate base subject to FERC's exclusive jurisdiction. *Id.* at D44-D53.

In the retail situation, however, FERC recognized both the States' continuing jurisdiction under Section 201 over "facilities used in local distribution," and the absence of any bright line to distinguish those facilities from interstate transmission facilities. The Commission therefore adopted a test to distinguish between transmission facilities and local distribution facilities, based on the function and technical characteristics of the facilities. Pet. App. D19-D20.[3] FERC also stated that it would defer to state recommendations in such matters, including where to draw the jurisdictional line between transmission and local distribution under FERC's test. *Id.* at D41-D52.

FERC further clarified several other aspects of its exercise of jurisdiction over unbundled transmission for

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[3] The test takes into account the following factors:

> (1) Local distribution facilities are normally in close proximity to retail customers; (2) Local distribution facilities are primarily radial in character; (3) Power flows into local distribution systems; it rarely, if ever, flows out; (4) When power enters a local distribution system, it is not reconsigned or transported on to some other market; (5) Power entering a local distribution system is consumed in a comparatively restricted geographical area; (6) Meters are based at the transmission/local distribution interface to measure flows into the local distribution system; (7) Local distribution systems will be of reduced voltage.

Pet. App. D19-D20.

retail sale. First, FERC emphasized that in exercising jurisdiction over the rates, terms, and conditions of the transmission component of unbundled retail transactions, it was not asserting authority either to order the unbundling of retail transactions or to order retail transmission to an ultimate consumer. Rather, its jurisdiction attaches only *if* retail transmission has been unbundled from the retail sale, either voluntarily by the utility or as a result of a state-ordered retail program. Pet. App. D44. Second, FERC clarified that its jurisdiction over the rates, terms, and conditions of unbundled retail transmission would not affect matters traditionally left to the States, "including authority to regulate the vast majority of generation asset costs, the siting of generation and transmission facilities, and decisions regarding retail service territories." *Id.* at D12; see also *id.* at D46 & n.544.

Order No. 888 also addresses problems created by "stranded costs," *i.e.*, a utility's sunk plant and other costs that it cannot recoup when customers, who previously took bundled service from the utility, take advantage of open-access transmission to purchase cheaper power from other suppliers. Pet. App. C11. Order No. 888 affords utilities an opportunity to recover such costs from a former customer that purchased its power requirements from the utility, but only if (a) the customer uses the former utility's transmission system to reach the new supplier, and (b) the utility shows a "reasonable expectation" that it would have continued to serve that customer beyond the end of its contract term. *Id.* at C11, C42-C48, D53-D54. With respect to costs stranded where retail customers are able to find new suppliers as a result of state retail unbundling, FERC recognized the primacy of state jurisdiction, and therefore took the position

that it would serve as a forum for cost recovery only if a state regulator lacked authority to do so and the departing customer uses a FERC transmission tariff to reach its new supplier. *Id.* at D80-D84, E91-E96.[4]

3. In a unanimous per curiam decision, the court of appeals upheld FERC's rules "in nearly all respects." Pet. App. C8.[5] The court first held that FERC had authority to require open access by virtue of its authority under Sections 205 and 206 to remedy undue discrimination by public utilities. *Id.* at C16-C19. The court of appeals relied in part on its decision in *Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988), in which it upheld a similar open-access requirement imposed by FERC on natural gas transportation under parallel provisions of the Natural Gas Act (NGA). See Pet. App. C17-C19, C21-C22. The court further held that FERC permissibly relied on generic findings of undue discrimination by utilities, and that FERC therefore was not required to find each individual utility's rates or practices unlawful. *Id.* at C19-C22.

The court also affirmed the jurisdictional basis for Order No. 888. Pet. App. C26-C38. The court explained that "[b]oth FPA [Sections] 201(a) and (b) clearly and unambiguously confer upon FERC jurisdiction over the 'transmission of electric energy in interstate commerce.'" *Id.* at C30-C31. The court

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[4] FERC also stated that it would serve as the primary forum for recovery of stranded costs where former retail customers become wholesale customers through what is known as municipalization or municipal annexation. Pet. App. C79.

[5] The court remanded to the agency to explain its treatment of certain stranded energy costs and to provide a reasonable cap on certain contract extensions. Pet. App. C12.

observed (*id.* at C31-C32) that this Court held in *FPC* v. *Florida Power & Light Co.*, 404 U.S. 453 (1972), that the very interconnection of utilities to the interstate grid results in a commingling of electricity and energy flows across state lines in interstate commerce, and under that precedent, "the FPA gives FERC the authority to regulate the transmissions at issue here, whether retail or wholesale." Pet. App. C33. The court also sustained FERC's decision not to assert jurisdiction over retail transmission that remains bundled with retail sales, reasoning that the Act is ambiguous with respect to the issue and that FERC's decision "represents a statutorily permissible policy choice to which [the court] must * * * defer under *Chevron*." *Id.* at C34. At the same time, the court rejected the challenge by certain States to FERC's exercise of jurisdiction over local distribution facilities that are used in wholesale transactions. The court concluded that since "FPA [Section] 201(a) makes clear that all aspects of wholesale sales are subject to federal regulation, regardless of the facilities used[,] FERC's assertion of jurisdiction over all wholesale transmissions, regardless of the nature of the facility, is clearly within the scope of its statutory authority." *Id.* at C37.

The court further held that FERC could permit recovery of retail stranded costs, in situations in which customers take advantage of state-ordered wheeling and state commissions lack the authority to award recovery of such costs. The court reasoned that "costs" are not jurisdictional and, thus, while Section 201(b) of the Act denies FERC jurisdiction over "facilities used for the generation of electric energy," 16 U.S.C. 824(b), "that provision does not necessarily prevent FERC from including *costs* relating to generating facilities in

transmission *rates*, over which FERC indisputably has jurisdiction." Pet. App. C81.

ARGUMENT

1. a. Petitioner Board of Water, Light and Sinking Fund Commissioners of the City of Dalton, Georgia (Dalton) argues (00-800 Pet. 7-10, 14-22) that FERC's reliance on generic findings of undue discrimination and its open-access remedy conflict with Section 206(a)'s requirement that FERC must premise a remedy on a finding that each individual utility's practice "affecting" a rate "is" unduly discriminatory.[6] That contention lacks merit.

FERC specifically concluded that "there is more than sufficient reason to believe that transmission monopolists *currently* engage in unduly discriminatory practices, and that they will continue to engage in unduly discriminatory practices, unless [FERC] fashion[s] a remedy to eliminate their ability and incentive to do so." 00-809 Pet. App. 216a (emphasis added). FERC based that finding on its own experience in reviewing applications and complaints, public comments presenting examples and allegations of widespread discrimination, and its determinations concerning the existence of systemic monopoly conditions and the economic self-interest of transmission monopolists–as well as FERC's expert prediction that such discrimination would likely

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[6] Dalton also suggests (00-800 Pet. 16-18) that its own circumstances justify the conclusion that FERC erred in making generic findings of discrimination and imposing a generic remedy. The court of appeals, however, found that contention not ripe for review, Pet. App. C24, and Dalton does not challenge that ruling in this Court.

increase in the future. Pet. App. C20-C21; 00-809 Pet. App. 209a-218a, 213a-214a, 315a-331a.[7]

The court of appeals therefore properly held that the agency's rules need not be premised on "specific findings" for each individual company where, as here, the agency's factual determinations are reasonable. Pet. App. C21. The court of appeals noted that it had previously upheld FERC's authority to proceed by rulemaking in exercising its parallel authority to address discriminatory practices under Section 5(a) of the NGA, 15 U.S.C. 717d(a), that Congress had ratified that approach in 42 U.S.C. 7173(c), and that the court had rejected similar challenges to FERC's ordering of open-access in the natural gas industry in *Associated Gas Distributors*, 824 F.2d at 1008. The court of appeals' decision upholding FERC's exercise of that settled authority in Order No. 888 presents no issue warranting this Court's review.

b. Dalton also contends (00-800 Pet. 22-27) that Order No. 888 conflicts with *Otter Tail Power Co.* v. *United States*, 410 U.S. 366 (1973). In that case, this Court held that the FPA did not preempt an antitrust remedy that ordered involuntary wheeling (*i.e.*, mandatory transmission for a third party), reasoning that "[s]o far as wheeling is concerned, there is no authority

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[7] It is well-settled that an agency may rely on established economic principles in promulgating rules. See, *e.g.*, *Permian Basin Area Rate Cases*, 390 U.S. 747, 792-795 (1968) (upholding Commission's rejection of contract pricing based on considerations of, inter alia, "market imperfections" and a "monopsonistic environment"); see also Pet. App. C22. Dalton does not challenge either that proposition or the Commission's authority to proceed by rulemaking rather than case-by-case adjudication. See 42 U.S.C. 7173(c) ("[T]he establishment of rates and charges under [the FPA] * * * may be conducted by rulemaking procedures.").

granted the Commission under Part II of the Federal Power Act to order it, for the bills originally introduced contained common carrier provisions which were deleted." *Id.* at 375. As the court of appeals explained, however, *Otter Tail* does not address whether the Commission may order wheeling in the exercise of its authority under Sections 205 and 206 to remedy undue discrimination. Pet. App. C18-C19. Those provisions specifically confer on FERC the authority to prescribe rates and practices upon a finding of undue discrimination, and the court of appeals correctly held that FERC has reasonably construed those provisions as conferring broad authority to remedy unduly discriminatory behavior by an open-access requirement. *Id.* at C19. As the court of appeals also pointed out (C18-C19), that court rejected similar arguments based on *Otter Tail* in *Associated Gas Distributors* some 13 years ago. See 824 F.2d at 998-999. In this respect as well, then, the court of appeals' decision breaks no new ground and presents no issue warranting review by this Court.[8]

2. The petitioners in No. 00-568 are nine state regulatory commissions (the States) that challenge (Pet. 12-19) FERC's jurisdiction over the transmission service

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[8] There similarly is no merit to Dalton's claim (00-800 Pet. 26-27) that the Commission's open-access rule is inconsistent with the authority to order wheeling on a case-by-case basis under Section 211 of the FPA, 16 U.S.C. 824j. Nothing in Section 211 undermines the Commission's remedial authority under Section 206. See 16 U.S.C. 824k(e)(1) (Section 211 "shall not be construed as limiting or impairing any authority of the Commission under any other provision of law."); see also 00-800 Pet. App. 69a-70a. As the Commission explained, the authority conferred by Section 211 was simply inadequate to meet the industry-wide conditions it sought to address in Order No. 888. *Id.* at 45a-46a.

involved in unbundled retail transactions. The court of appeals properly rejected their contentions.

a. Section 201(b) explicitly gives FERC jurisdiction over all "transmission of electric energy in interstate commerce" and "all facilities for such transmission," regardless of whether the transmission is part of a wholesale or retail transaction. In *FPC* v. *Florida Power & Light Co.*, 404 U.S. 453, 462-463 (1972), this Court recognized that when a utility's transmission lines connect to an interstate grid, the utility's energy commingles with that of other utilities so that inevitably some energy is transmitted across state lines and becomes interstate in nature.[9] The court of appeals therefore correctly concluded that "the FPA gives FERC the authority to regulate the transmissions at issue here, whether retail or wholesale." Pet. App. C33. The States' arguments to the contrary lack merit.

i. The States argue (00-568 Pet. 12) that the court of appeals improperly deferred to the Commission's view of its jurisdiction. The court held, however, that it was bound by this Court's interpretation in *Florida Power & Light* of "interstate transmission" under Section 201, and held only alternatively that it would defer to

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[9] For that reason, the States' reliance (00-568 Pet. 15-16) on Section 201(c), 16 U.S.C. 824(c), which states that energy is transmitted in interstate commerce if "transmitted from a State and consumed at any point outside thereof," is misplaced. With transmission interconnection, some of the electricity generated and transmitted in one State is almost inevitably consumed "outside thereof." That conclusion, however, does not create a null set of "intrastate transmission" under the FPA, because utilities may have no interconnection that would permit the physical transmission of power outside of a State, such as in Alaska, Hawaii, and most areas of Texas. See Pet. App. D43 n.541.

FERC's interpretation of its jurisdictional authority. See Pet. App. C33. In any event, this Court repeatedly has deferred to an agency's reasonable interpretation of a statute affecting the scope of its jurisdiction. See, *e.g.*, *Reiter* v. *Cooper*, 507 U.S. 258, 269 (1993); *EEOC* v. *Commercial Office Prods. Co.*, 486 U.S. 107, 115 (1988); *NLRB* v. *United Food & Commercial Workers Union*, 484 U.S. 112, 123 (1987); *CFTC* v. *Schor*, 478 U.S. 833, 845 (1986); see also *Mississippi Power & Light Co.* v. *Moore*, 487 U.S. 354, 380-382 (1988) (Scalia, J., concurring in the judgment) (collecting cases on question of deference to agency's interpretation of statute concerning its jurisdiction).

ii. The States argue (00-568 Pet. 14-15) that Order No. 888 conflicts with the statements by FERC and the Federal Power Commission (FPC) in congressional hearings and briefs to this Court that Section 201 does not extend the Commission's jurisdiction to retail sales. Neither FERC nor the FPC, however, has ever taken a position on the jurisdictional issues presented in this case. In Order No. 888, FERC addressed for the first time its view of the jurisdictional consequences of dramatic changes since enactment of the FPA, *i.e.*, the increase in competition in the electric utility industry and the advent of unbundled services. In light of those economic realities, FERC was well within its broad authority "to 'adapt [its] rules and policies to the demands of changing circumstances.'" *FDA* v. *Brown & Williamson Tobacco Corp.*, 120 S. Ct. 1291, 1313 (2000) (quoting *Motor Vehicle Mfrs. Ass'n of United States* v. *State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 42, 103 (1983) (quoting *Permian Basin Area Rate Cases*, 390 U.S. 747, 784 (1968))); see also *American Trucking Ass'ns* v. *Atchison, T.& S.F. Ry.*, 387 U.S. 397, 415 (1967) ("[T]he Commission, faced with new

developments, or in light of reconsideration of the relevant facts and its mandate, may alter its past interpretation.").

iii. The States further argue (00-568 Pet. 16) that Order No. 888 conflicts with Section 212(h) of the Act, 16 U.S.C. 824k(h), which sets forth the terms, conditions, and limitations on FERC's authority under Section 211, 16 U.S.C. 824j, to require transmission wheeling on a case-by-case basis, and provides that nothing in Section 212(h) "shall affect any authority of any State or local government under State law concerning the transmission of electric energy directly to an ultimate consumer." That provision has no application here, and in no way purports to limit FERC's jurisdiction under Section 201(b) over the rates, terms, and conditions of the transmission of electric energy in interstate commerce. Section 212(h) simply prohibits FERC from ordering transmission directly to an ultimate consumer, and in the challenged orders FERC disavowed any power to do so. Pet. App. D44. Moreover, when a utility engages in retail unbundling, either voluntarily or as required by state law, the States retain authority under Order No. 888 over local matters such as power production, customer service, and local reliability. *Id.* at D44-D46.

iv. The States assert (00-568 Pet. 17) that the Commission's exercise of jurisdiction over the transmission component on an unbundled retail transaction conflicts with this Court's observation in *FPC* v. *Southern California Edison Co.*, 376 U.S. 205, 215 (1964), that Section 201 creates a "bright-line" jurisdictional test between wholesale (*i.e.*, sales for resale) and retail (*i.e.*, direct) sales of energy. Order No. 888, however, does not depart from that test, but rather requires FERC to distinguish between facilities used for *transmission* and

facilities used for *local distribution*.[10] Indeed, the Court in *Southern California Edison*, 376 U.S. at 210 n.6, acknowledged the absence of such a bright-line distinction in that respect, concluding that the issue "involves a question of fact to be decided by [the agency] as an original matter." See also *Connecticut Light & Power Co.* v. *FPC*, 324 U.S. 515, 531-536 (1945).[11]

v. The States argue (00-568 Pet. 18) that, as a policy matter, Order No. 888 undermines competition because it will encourage States not to order retail unbundling for fear of losing jurisdiction over transmissions associated with retail transactions. That contention erroneously assumes that States will not weigh their consumers' best interests in deciding for, or against, retail wheeling, but will be concerned only with protecting their own jurisdiction. In any event, the States have made no showing that Order No. 888 actually has deterred any State from ordering retail

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[10] Contrary to the States' suggestion (00-568 Pet. 17), the decision below does not conflict with *Northern States Power Co.* v. *FERC*, 176 F.3d 1090, 1096 (8th Cir. 1999), cert. denied, 120 S. Ct. 1221 (2000), which addressed aspects of Order No. 888's curtailment provisions. The decision in that case did not address FERC's jurisdiction over unbundled retail transmissions, facilities used in wholesale transactions, or stranded costs caused by FERC's open-access requirement.

[11] The States' reliance (00-568 Pet. 18) on *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Comm'n*, 461 U.S. 375, 394 (1983), for the proposition that "mere interconnection of electric utilities is not enough to defeat state jurisdiction" is likewise misplaced. In that case, the Court had already determined that the FPA did not cover the transactions by rural power cooperatives that were at issue, before finding that regulation of wholesale rates was within the legitimate scope of local interests, notwithstanding a connection to the interstate grid. *Id.* at 384-385.

unbundling, and we have been advised by FERC that many States have ordered retail unbundling even after Order No. 888 became effective.

b. The States also challenge (00-568 Pet. 19-21) FERC's exercise of jurisdiction over local distribution facilities used in wholesale transmission transactions. The court of appeals properly rejected that argument, reasoning that Section 201(b) limits FERC jurisdiction over local distribution facilities "*except* as specifically provided in this subchapter and subchapter III," 16 U.S.C. 824(b)(1) (emphasis added), and Section 201(a) "makes clear that all aspects of wholesale sales are subject to federal regulation, regardless of the facilities used." Pet. App. C37. Consistent with Section 201(b)'s reservation of state jurisdiction over "facilities used in local distribution," Order No. 888 preserves the traditional areas of state regulation. Thus, where a public utility is transmitting unbundled energy to an end user —*i.e.*, where the transmission is connected to a retail rather than a wholesale transaction—Order No. 888 acknowledges that some of the facilities involved are local distribution facilities subject to state jurisdiction, and Order No. 888 establishes a test for defining the jurisdictional line on a case-by-case basis. *Id.* at D19-D20.

For similar reasons, the States err in arguing (00-568 Pet. 20) that Order No. 888 conflicts with this Court's observation in *Connecticut Light & Power Co.*, 324 U.S. at 531, that Congress's preservation of state jurisdiction in Section 201(b) over "facilities used in local distribution" is "a limitation on jurisdiction and a legal standard that must be given effect," regardless of whether the facility carries out-of-state energy. In Order No. 888, FERC has exercised jurisdiction over those facilities used in wholesale transactions, and it

has established a test to distinguish those facilities used for local distribution from those used for unbundled retail transmission. As the court of appeals concluded, Order No. 888 reasonably "recognizes the current reality that many primarily retail utilities engage in both local distribution and interstate transmissions, and seeks through the seven factors to discern each facility's primary function." Pet. App. C38.

There is likewise no merit to the States' contention (00-568 Pet. 19, 21) that the court of appeals' ruling upholding FERC's authority over all facilities used in wholesale transactions allows "FERC to usurp state power to ensure reliable local distribution," permits utilities to evade state regulation, and violates Congress's ban in Section 212(h), 16 U.S.C. 824k(h), on sham wholesale transactions. FERC stressed in its rulemaking that Order No. 888 would not affect traditional state jurisdiction over local service concerns, including reliability. Pet. App. D44-D53. Order No. 888 also does not affect the States' ability to set bundled retail rates, including a cost component reflecting use of facilities to deliver power to the ultimate consumer. FERC further stated that it would address on a case-by-case basis the possibility that transactions may be structured to avoid federal regulation, see, *e.g.*, *id.* at D52, and the States offer no reason to believe that FERC would approve a sham transaction barred by Section 212(h).

c. The States finally argue (00-568 Pet. 22-24) that FERC lacks the "backstop" authority to address requests for recovery of stranded costs arising out of state-ordered retail unbundling in the event that a state regulator lacks authority to provide for such recovery. The court of appeals correctly held, however, that the inclusion of stranded costs relating to genera-

tion facilities in transmission rates is a legitimate exercise of FERC's authority over transmission rates, because "[r]ates are jurisdictional; costs are not." Pet. App. C80-C81. For example, both FERC and a state commission may legitimately take the exact same plant costs into consideration in setting rates within their respective bailiwicks for setting wholesale and retail rates. *Id.* at C81. As the court explained, if a utility seeks to recover retail stranded costs in its FERC-jurisdictional transmission rates, FERC will exercise its traditional cost-of-service ratemaking jurisdiction to review those costs. *Ibid.* As the court further explained, both retail and wholesale stranded costs can be viewed as "costs" of providing transmission services because, while "such costs are not a cost of operating the physical transmission system, nevertheless, they are an economic cost incurred as a result of being required to provide retail transmission." *Id.* at C83 (quoting *id.* at E94 n.708). While agreeing that generation-related retail costs are not typically costs relating to transmission services, the court correctly held that "the fundamental changes wrought by state-ordered retail wheeling, as well as the narrow circumstances in which FERC will consider stranded-cost recovery claims, justify the conclusion that these costs are costs of providing transmission service." *Ibid.*[12]

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[12] The States similarly err in challenging (00-809 Pet. 24) FERC's exercise of jurisdiction over stranded costs in certain so-called "retail-turned-wholesale" situations where, for example, a municipal utility becomes the conduit by which a retail customer can switch from its historical local utility power supplier, using the local utility's FERC open access transmission tariff to reach a new supplier. Pet. App. D64-D65, E71-E78, F16-F19; 00-809 Pet. App. 499a n.479. In those situations, assuming the utility carries its burden of proof, FERC will provide for recovery through a customer-

FERC, moreover, has stated that "[t]he only circumstance" in which it would "entertain requests" to recover stranded costs relating to retail wheeling "is when the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required." Pet. App. C79. No such claim for recovery has been presented to the Commission in the almost five years since it issued Order No. 888, and the hypothetical circumstance of a state regulator not having authority to address the problem may never arise.

3. Petitioner Enron Power Marketing, Inc. argues (00-809 Pet. 11-16) that Section 201(b) requires the Commission to assert jurisdiction over transmission of electric energy that remains part of a bundled retail sale. The court of appeals, however, correctly declined to hold that the Commission must treat all bundled retail sales as separate sales and transmission services and assert jurisdiction over the transmission component of the transactions.

Although Section 201 clearly gives FERC jurisdiction over transmission in interstate commerce and wholesale sales, and the Act gives States jurisdiction over local distribution facilities and retail sales, the "statute is much less clear about exactly where the lines between those activities are to be drawn." Pet.

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specific surcharge to be added to the transmission rate. Pet. App. E85. The court of appeals correctly upheld FERC's authority in that respect, reasoning that "FERC's exclusive jurisdiction over all aspects of wholesale sales gives FERC all the authority it needs to include generation-related costs in rates, including even costs originally incurred to provide retail service." *Id.* at C91. Moreover, "[a]s in the retail wheeling context, these stranded costs are properly viewed as 'costs' of the former supplying utility's provision of open access transmission service." *Ibid.*

App. C34. The court of appeals therefore correctly held that "[a] regulator could reasonably construe transmissions bundled with generation and delivery services and sold to a consumer for a single charge as either transmission services in interstate commerce," over which FERC has jurisdiction, "or as an integral component of a retail sale," over which the States have jurisdiction. In those circumstances, the court properly deferred to FERC's decision to treat bundled transmission as part of retail sales as "a statutorily permissible policy choice." *Ibid.*[13]

Enron also contends (00-809 Pet. 17-22) that FERC's decision not to assert jurisdiction over bundled retail transmissions will have a detrimental impact on nondiscriminatory access to transmission services. FERC specifically considered the competing policy issues at stake, and permissibly determined that an exercise of its jurisdiction was not necessary to achieve nondiscriminatory open access to transmission services. In its

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[13] Enron argues (00-809 Pet. 14-15) that FERC's interpretation conflicts with this Court's interpretation in *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 636 (1972), of Section 1(b) of the NGA, 15 U.S.C. 717(b), a provision parallel to Section 201(b) of FPA. That case did not address, however, the Commission's authority to regulate transmission bundled with retail sales, but simply held that the reservation to the States of jurisdiction over retail natural gas sales did not preclude the Commission from exercising jurisdiction over the curtailment of natural gas deliveries in times of shortage. 406 U.S. at 623. Enron similarly errs in relying (00-809 Pet. 15-16.) on the D.C. Circuit's decision in *Mississippi River Transmission Corp.* v. *FERC*, 969 F.2d 1215 (1992), which held that FERC may regulate the transportation embedded in a retail natural gas sale. That decision construed FERC's authority to issue a certificate for pipeline service under Section 7(c) of the NGA, 15 U.S.C. 717f(c), a provision with no parallel in the FPA.

Notice of Proposed Rulemaking, the Commission explained that its approach "raises the possibility that the quality of transmission service for retail purposes will be superior to the quality of transmission service offered for wholesale purposes," 00-809 Pet. App. 634a, and therefore sought public comment on how its "bifurcated approach would affect the public utility's incentives to provide nondiscriminatory open access wholesale transmission service," *id.* at 635a.

In its Final Rule, the Commission explained that "[t]he majority of commenters addressing this issue believe that unbundling retail services is unnecessary to establish a competitive market and to achieve non-discriminatory open access transmission." 00-809 Pet. App. 234a. After reviewing those comments, as well as views of commenters opposing the Commission's approach, the Commission concluded that "[a]lthough the unbundling of retail transmission and generation, as well as wholesale transmission and generation, would be helpful in achieving comparability," the Commission did "not believe it is necessary." *Id.* at 235a. That policy judgment is reasonable, and does not warrant this Court's review.[14]

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[14] In the event that the Court were to grant the States' petition challenging Order No. 888's exercise of jurisdiction, the Commission would not oppose the Court's granting of Enron's petition as well.

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

BARBARA D. UNDERWOOD
Acting Solicitor General

DOUGLAS W. SMITH
General Counsel

CYNTHIA A. MARLETTE
Deputy General Counsel

SUSAN J. COURT
Associate Solicitor

TIMM L. ABENDROTH
Attorney
Federal Energy Regulatory Commission

JANUARY 2001

Supreme Court, U.S.
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Nos. 00-568 AND 00-809

In The

Supreme Court of the United States

People of the State of New York and the Public Service Commission of the State of New York, et al.
Petitioners,

v.

Federal Energy Regulatory Commission, et al.,
Respondents.

Enron Power Marketing, Inc.,
Petitioner,

v.

Federal Energy Regulatory Commission, et al.,
Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

JOINT APPENDIX (Vol. 1 of 2)

Louis R. Cohen *
Wilmer, Cutler & Pickering
2445 M Street, N.W.
Washington, D.C. 20037-1420
(202) 663-6000
For Petitioner/Respondent, Enron Power Mkt., Inc.

Lawrence G. Malone *
Public Service Commission
of the State of New York
Three Empire State Plaza
Albany, NY 12223-1350
(518) 474-2510
For Petitioners, People of the State of New York, et al.

Theodore B. Olson *
Solicitor General
Edwin S. Kneedler
Deputy Solicitor General
Austin C. Schlick
Department of Justice
950 Pennsylvania Ave., N.W.
Room 5259
Washington, D.C. 20530-0001
(202) 514-2217
For Respondent, Federal Energy Regulatory Commission

* COUNSEL OF RECORD

BECKER GALLAGHER LEGAL PUBLISHING, INC.
CINCINNATI, OH 800-890-5001

James Bradford Ramsay
General Counsel
Sharla M. Barklind
Associate General Counsel
National Association of
Regulatory Utility Commissioners
1101 Vermont Ave., N.W., Ste. 200
Washington, D.C. 20005
(202) 898-2208

Catherine D. Bedell
General Counsel
Richard Bellak
Associate General Counsel
Florida Public Service
Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850
(850) 413-6092

Alan G. Lance
Attorney General
Donald L. Howell, II
Deputy Attorney General
Idaho Public Utilities
Commission
472 W. Washington Street
P.O. Box 83720
Boise, ID 83720-0074
(208) 334-0312

John J. Farmer, Jr.
Attorney General
State of New Jersey
Helene S. Wallenstein
Sr. Deputy Attorney General
Attorney for New Jersey Board
of Public Utilities
124 Halsey Street, 5th Floor
P.O. Box 45029
Newark, New Jersey 07101
(973) 648-4846

Counsel for Petitioners/Respondents
State Public Service Commissions

William H. Chambliss
General Counsel
C. Meade Browder, Jr.
Attorney
Virginia State Corp. Comm'n
Office of General Counsel
P.O. Box 1197
Richmond, VA 23218
(804) 371-9671

Christine O. Gregoire
Attorney General
William Berggren Collins
Sr. Assistant Attorney General
Robert D. Cedarbaum, Sr. Counsel
(for the Washington Utilities and
Transportation Commission)
P.O. Box 40128
Olympia, WA 98504-0128
(360) 664-1188

Harvey L. Reiter
(for Vermont Dept. of Public Service)
Morrison & Hecker
1150 18th Street, N.W., Ste. 800
Washington, D.C. 20036
(202) 785-9100

Harry Ivey
(for Wyoming Public Service Comm'n)
Attorney General's Office
State of Wyoming
123 Capitol
Cheyenne, WY 82002
(307) 777-7824

Jo Anne Sanford
North Carolina Utilities Comm'n
Robert P. Gruber
Public Staff - North Carolina
Utilities Comm'n
Gisele L. Rankin, Staff Attorney
P.O. Box 29520
Raleigh, NC 27626-0520
(919) 733-2435

(Counsel continued on inside back cover)

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NOTICE

The following documents have been omitted in the printing of this Appendix. These documents may be found in Petitioner Enron Power Marketing, Inc.'s Appendix to its Petition for Writ of Certiorari (00-809) at the following pages:

APPENDIX A:

Judgment of the United States Court of Appeals for the District of Colombia Circuit filed 6/30/00 . . . . . 1a

APPENDIX B:

Opinion of the United States Court of Appeals for the District of Columbia Circuit filed 6/30/00 . . . . . 3a

APPENDIX C:

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APPENDIX F:

Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Notice of Proposed Rulemaking and Supplemental Notice of Proposed Rulemaking, Notice of Proposed Rulemaking, [1988-1998 Proposed Regs.] F.E.R.C. Stats, & Regs. ¶32,514 (1995) (pertinent portion) 33,047-33,085 . . . . . 553a

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Some may also be found in the Petitioner's People of the State of New York and The Public Service Commission of the State of New York's Appendix to its Petition for Writ of Certiorari (00-568) at the following pages:

APPENDIX A:

Order of United States Court of Appeals for the District of Columbia Circuit filed 8/22/00 . . . . . A-1

APPENDIX B:

Judgment of United States Court of Appeals for the District of Columbia Circuit filed 6/30/00 . . . . . B-1

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RELEVANT DOCKET ENTRIES IN DISTRICT OF COLUMBIA CIRCUIT

DOCKET FOR CASE NOS.: 00-568 and 00-809
(Court of Appeals Docket No.: 97-1715, Complex)

12/5/97	PETITION FOR REVIEW CASE docketed. Petition for Review filed by Petition Transm Access Plcy. [314268-1] (mcm) [97-1715]
1/2/98	CLERK'S ORDER filed granting non-party motion to intervene filed by VT Dept Pub Srvc [316424-1]. (sha) [97-1715]
1/12/98	CLERK'S ORDER filed granting non-party motion to intervene filed by Edison Elec Inst [320723-1] granting non-party motion to intervene filed by City & Cty San [320823-1] granting non-party motion to intervene filed by Oprt Co Amer elec [318537-1]. (mcm) [97-1715]
4/30/98	CLERK'S ORDER filed, on court's own motion, that cases are consolidated; FURTHER ORDERED that EEI motion for leave to amend is granted. The amended motions are dismissed as moot, in light of 1/12/98 order granting EEI leave to intervene in 97-1715; FURTHER ORDERED that motions of WA Util, So CA Gas, KS City, PSI Energy, and Cincinnati Gas to intervene be granted; FURTHER ORDERED that parties advise the court by 5/15/98 of any remaining motions, etc.; FURTHER ORDERED that petitioners show cause, by 6/01/98 why the

petitions for review in 98-1110, 98-1117, 98-1121, 98-1130, 98-1133, 98-1135, 98-1138, 98-1144, 98-1151, 98-1157, 98-1158, 98-1161, 98-1164, 98-1167, 98-1179 should not be dismissed as incurably premature. Responses limited to 20 pages and failure to respond will result in dismissal. Respondent may file a reply, limited to 10 pages, within 10 days thereafter; FURTHER ORDERED that by 6/01/98, parties shall provide a list of five lead counsel. Within 30 days thereafter, counsel shall provide joint proposed briefing schedule, etc.; FURTHER ORDERED that parties shall resubmit Rule 26.1 disclosure statements by 6/01/98, etc.; FURTHER ORDERED that respondent shall provide by 5/15/98 a current master service list; Clerk is directed to send a copy of this order by certified mail to petitioners in cases identified above. (su) [97-1715 98-1179 98-1180]

6/2/98 CLERK'S ORDER filed granting non-party motion to intervene filed by Suffolk Cty Elec [355394-1] granting non-party motion to intervene filed by Fl Pub Svc Cmsn [354722-1] granting non-party to intervene filed by Rochester Gas & Elec [354086-1] granting non-party motion to intervene filed by Carolina Power [353289-1] granting non-party motion to intervene filed by FL Power & Light [353301-1] granting non-party motion to intervene filed by Pub Svc Elec Gas [353314-1] granting non-party motion to intervene filed by OH Consum Coun, Natl Assn St Util [353328-1] granting non-party motion to

intervene filed by Dairyland Power Coop [353189-1] granting non-party motion to intervene filed by Natl Rural Elec Coop [353333-1] granting non-party motion to intervene filed by NE TX Elec Coop Inc, Sam Rayburn Elec G&T, TX-LA Elec Coop TX [352000-1] granting non-party motion to intervene filed by FL Muni Power Agcy [352033-1] granting non-party motion to intervene filed by MI S Ctrl Power Agcy [352034-1] granting non-party motion to intervene filed by Wolverine Power [352035-1] granting non-party motion to intervene filed by Pub Svc Cmsn St NY [352047-1] granting non-party motion to intervene filed by Natl Assn Reg Util [352050-1] granting non-party motion to intervene filed by NY St Elec & Gas [350758-1] granting non-party motion to intervene filed by GA Transm Corp [354045-1]. (mcm) [97-1715]

8/13/98 PER CURIAM ORDER: on the court's own motion, that these case be designated "COMPLEX". FURTHER ORDERED that the order to show cause be discharged. FURTHER ORDERED that the petitions for review in No. 98-1110, 98-1117, 98-1121, 98-1130, 98-1133, 98-1135, 98-1138, 98-1144, 98-1151, 98-1157, 98-1161, 98-1167 and 98-1179 be dismissed as incurably premature. [374127-1] FURTHER ORDERED that the initial briefing schedule is as follows (SEE ORDER FOR BRIEFING FORMATS) [374127-2]: Petitioner's brief due on 10/1/98 in 97-1715; Intervenor supprtng Petitioner's

brief due 10/1/98 in 97-1715; Respondent's brief due on 2/1/99 in 97-1715; Intervenor supportg Respondent's brief due 4/1/99 in 97-1715; Petitioner's reply brief due 5/3/99 in 97-1715; Intervenor supprt Petitioner's reply brief due 5/3/99 in 97-1715; Deferred appendix due on 6/10/99 in 97-1715; Final briefs due on 6/24/99 in 97-1715. FURTHER ORDERED that motion for leave to file joint proposed briefing schedule be granted. The Clerk is directed to file the lodged pleading [363672-1]. FURTHER ORDERED that the motion to exceed page limits be granted. FURTHER ORDERED that the motion to change party name be granted. The Clerk is directed to amend the docket to reflect that the intervenor's name is Enron Power Marketing, Inc. rather than the Coalition for a Competitive Elec Market [360864-1]. FURTHER ORDERED that the motion to intervene filed by IL Power Co [360901-1] be granted. FURTHER ORDERED that the motions adding a new attorney [356458-1] filed by 11 movants and Ontario Hydro [356721-1] be granted. Lead counsel are as follows: John Conway (FERC), Susan Court (FERC), Robert Zener, Robert Jablon, Jonathan Feinberg, Sara Schotland, Peter Kirby and Isaac Benkin (lead counsel for petitioners and intervenors). FURTHER ORDERED that the motion of Pacific Legal Fndtn for leave to participate as amicus [353194-1] and for leave to dispense with service on all parties be denied [353194-2]. This denial is without prejudice to PLF's refiling the motion for

leave within ten days of the date of this order, after serving all parties listed in the current master list. Before Judges Wald, Sentelle, Randolph. [97-1715] (mcm) [97-1715 98-1110 98-1117 98-1121 98-1130 98-1133 98-1135 98-1138 98-1144 98-1151 98-1157 98-1161 98-1167 98-1179]

8/13/98 PER ABOVE ORDER lodged motion establishing the initial briefing schedule [363672-1] is filed. (mcm) [97-1615]

10/1/98 BRIEF [DISCRIMINATORY DISCOUNTING AND FUNCTIONAL UNBUNDLING] filed by Petitioner Transm Access Plcy in 97-1715, Petitioner Transm Dpndnt Util in 98-1145, Petitioner Enron Power Mkt Inc in 98-1178 [386444-1]. Copies: 15. of service date 10/1/98. [97-1715, 98-1145, 98-1178] (mcm) [97-1715 98-1145 98-1178]

10/1/98 BRIEF [INVESTOR OWNED UTILITY PETITIONERS] filed by Investor IL Power Co in 97-1715, Petitioner Pub Svc Elec & Gas in 98-1119, Petitioner FL Power & Light in 98-1120, Petitioner Rochester Gas & Elec in 98-1124, Petitioner Carolina Power in 98-1125, Petitioner NE Util Svc Co in 98-1126, Petitioner NE Util Svc Co in 98-1127, Petitioner NY St Elec & Gas in 98-1139, Petitioner Boston Edison Co in 98-1162, Petitioner Ctrl VT Pub Svc Corp in 98-1162, Petitioner Niagra Mohawk Power in 98-1168, Petitioner Con Edison Co NY Inc in 98-1174,

Petitioner Con Edison Co NY Inc in 98-1175, Petitioner GPU Engy in 98-1176, Petitioner Edison Elec Inst in 98-1180 [386545-1]. Copies: 7. Certificate of service date 10/1/98. [97-1715, 98-1119, 98-1120, 98-1124, 98-1125, 98-1126, 98-1127, 98-1139, 98-1162, 98-1168, 98-1174, 97-1175, 98-1176, 98-1180] (mcm) [97-1715 98-1119 98-1120 98-1124 98-1125 98-1126 98-1127 98-1139 98-1162 98-1168 98-1174 98-1175 98-1176 98-1180]

10/2/98 BRIEF W/2 VOLUME APPENDIX OF LEGESLATIVE HISTORY [STATE COMMISSIONS] filed by Intervenor for Petitioner WA Util Trans Cmsn in 97-1715, Intervenor St NJ Bd Pub Util in 97-1715, Intervenor WY Pub Svc Cmsn in 97-1715, Intervenor for Petitioner ID Pub Util Cmsn in 97-1715, Intervenor for Petitioner NC Util Cmsn in 97-1715, Intervenor for Petitioner Natl Assn Reg Util in 97-1715, Intervenor for Petitioner FL Pub Svc Cmsn in 97-1715, Petitioner People St NY in 98-1111, Petitioner Pub Scv Cmsn St NY in 98-1111, Petitioner VA St Corp Cmsn in 98-1142, Petitioner AR Pub Svc Cmsn in Petitioner VT Dept Pub Srvc in 98-1148, Petitioner OH Coun in 98-1150, Petitioner Natl Assn St Util in 98-1155 [386734-1]. Copies: 7. Certificate of service date 10/1/98. [97-1715, 98-111, 98-1142, 98-1147, 98-1148, 98-1150, 98-1155] (mcm) [97-1715 97-1111 98-1142 98-1147 98-1148 98-1150 98-1155]

2/16/99 BRIEF filed by Respondent FERC in 97-1715 [416562-1]. Copies: 6. Certificate of service date 2/16/99. (mcm) [97-1715]

4/16/99 BRIEF filed by Intervenor Edison Elec Inst in 97-1715, Intervenor NY St Elec & Gas in 97-1715, Intervenor Cm Edison Co in 97-1715, Intervenor Consum Engy Co in 97-1715, Intervenor VA Elec Power Co in 97-1715, Intervenor New Engl Power Co in 97-1715, Intervenor WI Pub Svc Corp in 97-1715, Intervenor Atl City Elec Co in 97-1715, Intervenor for Repsondent FL Power & Light in 97-1715, Intervenor Rochester Gas & Elec in 97-1715; Intervenor FL Power Corp in 97-1715 [430200-1]. Copies: 6. Certificate of service date 4/16/99. (mcm) [97-1715]

5/18/99 REPLY BRIEF [DISCRIMINATORY DISCOUNTING AND FUNCTIONAL UNBUNDLING] filed by Petitioner Transm Access Plcy in 97-1715, Petitioner Transm Dpndnt Util in 98-1145, Petitioner Enron Power Mkt Inc in 98-1178 [436794-1]. Copies: 7. Certificate of service date 5/18/99. [97-1715, 98-1145, 98-1178] (mcm) [97-1715 98-1145 98-1178]

5/19/99 REPLY BRIEF [STATE COMMISSIONS] filed by Intervenor for Petitioner WA Util Trans Cmsn in 97-1715, Intervenor St NJ Bd Pub Util in 97-1715, Intervenor WY Pub Svc Cmsn in 97-1715, Intervenor for Petitioner Pub Stf NC Util Cmsn in 97-1715, Intervenor for Petitioner NC Util Cmsn in 97-1715,

Intervenor for Petitioner Natl Assn Reg Util in 97-1715, Intervenor FL Pub Svc in 97-1715,k Petitioner People St NY in 98-1111, Petitioner Pub Svc Cmsn St NY in 98-1111, Petitioner VA St Corp Cmsn in 98-1142, Petitioner VT Dept Pub Srvc in 98-1148, Petitioner OH Consum Coun in 98-1150, Petitioner Natl Assn St Util in 98-1155 [436812-1]. Copies: 7. Certificate of service date 5/18/99. [97-1715, 98-1111, 98-1142, 98-1147, 98-1148, 98-1150, 98-1155] (mcm) [97-1715 98-1111 98-1142 98-1147 98-1148 98-1150 98-1155]

8/19/99 FINAL BRIEF filed by Intervenors for Respondent, Enron Power Marketing, Inc., Electricity Consumers Resource Council, American Public Power Association, NE TX Elec Coop Inc, Sam Rayburn Elec G&T, Tex-La Elec Coop TX, Natl Rural Electric Cooperative Assoc., et al. in 97-1715 [458098-1]. Copies: 15. Certificate of service date 8/19/99. [STYLED AS JOINT BRIEF FOR ALL OTHER INTERVENORS IN SUPPORT OF RESPONDENT]. (lvs) [97-1715]

8/19/99 FINAL BRIEF filed by Petitioners Transm Access Plcy, Transm Dpndnt Util, Enron Power Mkt Inc [488131-1]. Copies: 15. Certificate of service date 8/19/99. [STYLED AS INITIAL BRIEF OF THE TRANSMISSION ACCESS POLICY STUDY GROUP, ENRON POWER MARKETING, INC. AND TRANSMISSION DEPENDENT UTILITY SYSTEMS ON FUNCTIONAL UNBUNDLING AND DISCOUNTING]. [97-

1715, 98-1145, 98-1178] (lvs) [97-1715 98-1145 98-1178]

8/19/99 FINAL REPLY BRIEF filed by Petitioners Transm Access Plcy, Transm Dpndnt Util, Enron Power Mkt Inc [458144-1]. Copies: 15. Certificate of service date 8/19/99. [STYLED AS REPLY BRIEF OF THE TRANSMISSION ACCESS POLICY STUDY GROUP, ENRON POWER MARKETING, INC. AND TRANSMISSION DEPENDENT UTILITY SYSTEMS ON FUNCTIONAL UNBUNDLING AND DISCOUNTING]. [97-1715, 98-1145, 98-1178] (lvs) [97-1715 98-1145 98-1178]

8/20/99 FINAL BRIEF for the Public Service Commissions of New York, Arkansas and Florida, ID Pub Util Cmsn, NC Util Cmsn, WY Pub Svc Cmsn, NJ Board of Public, VA Corp Cmsn, WA Util Trans Cmsn, VT Dept Pub Srvc, Natl Assn Reg Util [458523-1]. Copies: 15. Certificate of service date 8/19/99. [97-1715, 98-1142, 98-1147, 98-1148, 98-1162, 98-1169] (lvs) [97-1715 98-1142 98-1147 98-1148 98-1162 98-1169]

8/20/99 FINAL REPLY BRIEF filed by Petitioners/Intervenors VA St Public Service Commissions of NY, AR and FL, Natl Assn of Regulatory Util Cmsn, Pub Util Cmsn ID, NC and WY, NJ Board Pub Util, VA Corp Cmsn, WA Util Trans Cmsn, VT Dept Pub Srvc, OH Consum Coun, Natl Assn St Util [458643-1]. Copies: 15. Certificate of service

date 8/19/99. [97-1715, 98-1142, 98-1147, 98-1148, 98-1150, 98-1155, 98-1162, 98-1169] (lvs) [97-1715 98-1142 98-1147 98-1148 98-1150 98-1155 98-1162 98-1169]

8/20/99 APPENDIX [VOLUME I & II] OF LEGISLATIVE HISTORY FOR STATE COMMISSIONS' BRIEF filed by Petitioners/Intervenors Pub Svc Cmsn NY, AR, FL, Natl Assn of Regulatory Util Cmsn, Pub Util Cmsn ID, NC and WY, NJ Board Pub Util, VA Corp Cmsn, WA Util/Trans Cmsn, VT Dept Pub Srvc, OH Consum Coun [458663-1]. Copies: 10. Certificate of service date 8/19/99. [97-1715, 98-1142, 98-1147, 98-1148, 98-1150, 98-1155, 98-1162, 98-1169] (lvs) [97-1715 98-1142 98-1147 98-1148 98-1150 98-1155 98-1162 98-1169]

RELEVANT DOCKET ENTRIES BEFORE FEDERAL ENERGY REGULATORY COMMISSION

Issuance 19980421-0175	3/4/97	Ltr to Vice President A Gore, Jr providing final rules issued on promoting wholesale competition through open access non-discriminatory transmission servs by public utils etc under RM95-8 et al. Portland General Elec Co submits.
Submittal 19960530-0195	5/24/96	Motion for rehearing of Public Serv Commission of New York of Order 888 & 889 re open access transmission & stranded costs under RM95-8 & RM94-7.
Submittal 19960530-0202	5/24/96	Pennsylvania Public Util Commission member J Hanger submits ltr of dissent re 960523 petition for rehearing of Order 888 under RM95-8 & RM94-7.
Submittal	5/24/96	Appl of Coalition for

19960530-0279		Competitive Elec Market for reconsideration & clarification or in alternative rehearing of FERC's Order 888 re promoting wholesale competition etc.
Submittal 19960530-0188	5/23/96-5/24/96	Request of Virginia State Corp Commission for rehearing of Order 888 re open access transmission etc under RM94-7 & RM95-8.
Issuance 19960425-0263	4/24/96	Order 888 final rule re promoting wholesale competition thru open access nondiscriminatory svc/recovery of stranded costs by public utils. Corrected Hoecker.
Submittal 19950811-0061	8/7/95-8/10/95	Comments of NC Utilities Commission re notice of proposed rulemaking & suppl notice of proposed rulemaking re recovery of stranded cost by public utilities etc under RM95-8, et al.

NOTICE OF PROPOSED RULEMAKING - RECOVERY OF STRANDED COSTS BY PUBLIC UTILITIES AND TRANSMITTING UTILITIES IN DOCKET NO. RM-94-7-000
59 FED. REG. 35,274; 35,283-86

[pp. 35,274; 35,283-86]

[35,274]

SUMMARY: The Commission is proposing to amend its regulations to establish provisions concerning the recovery of wholesale and retail stranded costs by public utilities and transmitting utilities under sections 205, 206, 211 and 212 of the Federal Power Act. The Commission seeks public comment concerning the issues raised by the proposed rulemaking.

DATES: Written comments must be received by the Commission by September 9, 1994. Reply comments must be received by the Commission by October 11, 1994.

ADDRESSES: Send comments to: Office of the Secretary, Federal Energy Regulatory Commission, 825 North Capitol Street, NE., Washington, DC 20426.

FOR FURTHER INFORMATION CONTACT:

James H. Douglass, Office of the General Counsel, Federal Energy Regulatory Commission, 825 North Capitol Street, NE., Washington, DC 20426; Telephone: (202) 208-2143 (legal issues).

Michael A. Coleman, Office of Electric Power Regulation, Federal Energy Regulatory Commission, 825 North Capitol

Street, NE., Washington, DC 20426; Telephone: (202) 208-1236 (technical issues).

SUPPLEMENTARY INFORMATION: In addition to publishing the full text of this document in the **Federal Register**, the Commission also provides all interested persons an opportunity to inspect or copy the contents of this document during normal business hours in room 3104, at 941 North Capitol Street, NE., Washington, DC 20426.

The Commission Issuance Posting System (CIPS), an electronic bulletin board service, provides access to the texts of formal documents issued by the Commission. CIPS is available at no charge to the user and may be accessed using a personal computer with a modem by dialing (202) 208-1397. To access CIPS, set your communications software to use 300, 1200, or 2400 bps, full duplex, no parity, 8 data bits and 1 stop bit. CIPS can also be accessed at 9600 bps by dialing (202) 208-1781. The full text of this order will be available on CIPS for 30 days from the date of issuance. The complete text on diskette in WordPerfect format may also be purchased from the Commission's copy contractor, La Dorn Systems Corporation, also located in room 3104, 941 North Capitol Street, NE., Washington, DC 20426.

Notice of Proposed Rulemaking

June 29, 1994.

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I. Introduction

The Federal Energy Regulatory Commission (Commission) seeks public comment on amending its regulations to establish provisions concerning the recovery of wholesale and retail stranded costs by public utilities and

transmitting utilities under sections 205, 206, 211 and 212 of the Federal Power Act (FPA).[1] Wholesale stranded costs are defined as any legitimate, prudent and verifiable costs incurred by a public utility or a transmitting utility to provide service to a wholesale requirements customer that subsequently becomes, in whole or in part, an unbundled transmission services customer[2] of that public utility or transmitting utility. Retail stranded . . .

[35283]

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[1]A public utility is defined under section 201(e) of the FPA as "any person who owns or operates facilities subject to the jurisdiction of the Commission under this Part (other than facilities subject to such jurisdiction solely by reason of section 210, 211, or 212)." A transmitting utility is defined under section 3(23) of the FPA as "any electric utility, qualifying cogeneration facility, qualifying small power production facility, or Federal power marketing agency which owns or operates electric power transmission facilities which are used for the sale of electric energy at wholesale." Not all transmitting utilities are public utilities. For instance, a municipally-owned electric utility that owns transmission facilities which are used for the sale of electric energy at wholesale is a transmitting utility, but is not a public utility.

[2]An unbundled transmission services customer is one who purchases transmission as a product that is separate from the purchase of generation.

6. Recovery of Retail Stranded Costs

As discussed earlier, there are two general ways in which retail stranded costs are likely to occur:[50] (1) A retail franchise customer may, through State or local government action, become a wholesale customer who can then obtain unbundled transmission services in order to reach a new power supplier;[51] (2) a retail franchise customer may obtain voluntary unbundled retail transmission services from its existing power supplier in order to reach a new power supplier, or there may be a State or local action that results in the existing supplier **[35,281]** providing such retail transmission services.

In the first example (a retail franchise customer becomes an unbundled wholesale power and transmission customer), the Commission clearly has exclusive jurisdiction under sections 201, 205 and 206, or section 212 of the FPA, over the rate for the wholesale interstate transmission services[52] used by the new wholesale entity in order to reach its new generation supplier. In the second example, in which

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[50]Retail stranded costs may result from "self-help" actions such as customer self-generation, and this has long been a fact of life for utilities. *See, supra*, n.18. This proceeding does not address these situations.

[51]In addition, certain retail customers may become retail customers of a newly-created wholesale entity.

[52]Under FPA section 211, the Commission's authority to order wheeling does not turn on whether the transmission services will be in interstate commerce.

a retail franchise customer becomes a retail unbundled transmission customer of its former franchise utility, and a retail power customer of another utility, we conclude that we also have exclusive jurisdiction over the rates, terms and conditions for the retail interstate transmission services.[53]

(i) Jurisdictional Analysis

The Commission's jurisdiction over the rates, terms and conditions of transmission in interstate commerce derives from Congress' power to regulate interstate commerce under the United States Constitution[54] and the FPA. When Congress enacted the FPA, it gave the Commission exclusive jurisdiction over the rates, terms and conditions of transmission in interstate commerce by public utilities. The Supremacy Clause of the Constitution provides that federal laws enacted pursuant to the powers delegated to the federal government by the United States Constitution are the supreme law of the land.[55] Accordingly, to the extent that retail wheeling involves transmission in interstate commerce by public utilities, the rates, terms and conditions of such service

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[53]We make no determination here regarding the physical or jurisdictional distinctions between transmission and local distribution. Section 201(b)(1) of the FPA states that the Commission has no jurisdiction, except as specifically provided in Parts II and III of the FPA, over facilities used for local distribution. Nor do we address here whether States have authority to order retail wheeling in interstate commerce.

[54]U.S. Const. Art. I, § 8, cl.3.

[55]U.S. Const. Art. VI, cl.2.

are subject to the exclusive jurisdiction of the Commission, and the rates for such service must be filed with the Commission.[56]

Section 201 of the FPA, by its very words, does not limit the Commission's jurisdiction over transmission to transmission of electric energy in interstate commerce sold at wholesale.

Subsection 201(b)(1) of the FPA provides:

(b)(1) The provisions of this Part shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce * * * The Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy * * *

16 U.S.C. § 824(b)(1).

Much of the legislative history of the FPA indicates that Congress intended the Commission's jurisdiction to extend only to those matters which the *Attleboro* decision[57] held to be beyond the reach of the States. For instance, the

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[56]*See* Montana-Dakota Utilities Co. v. Northwestern Public Service Co., 341 U.S. 246, 251-52 (1951) (*Montana-Dakota*).

[57]Public Utilities Commission v. Attleboro Steam & Electric Co., 273 U.S. 83 (1927) (*Attleboro*). In *Attleboro*, the Supreme Court held that State regulation of the interstate sale of electricity was barred by the Commerce Clause because such regulation would impose a "direct burden" on interstate commerce.

report accompanying the Senate bill states that subsection (b) "leaves to the States the authority to fix local rates even in cases where the energy is brought in from another state."[58] The Senate report also states:

> The rate-making powers of the Commission are confined to those wholesale transactions which the Supreme Court held in [*Attleboro*] to be beyond the reach of the States. Jurisdiction is asserted also over all interstate transmission lines whether or not there is sale of the energy carried by those lines. * * *

S. Rep. No. 621, 74th Cong., 1st Sess. 48 (1935). Thus, federal jurisdiction over transmission lines is not dependent on whether those lines are used to effect a sale, wholesale or otherwise.

While the provisions of section 201 reserving certain regulatory authority to the States have been interpreted narrowly,[59] the courts have construed "in interstate commerce" broadly. The term does not turn on whether the

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[58]S. Rep. No. 621, 74th Cong., 1st Sess. 48 (1935). *See also* H.R. Rep. No. 1318, 74th Cong., 1st Sess. 8 (1935).

[59]While Congress may exercise its Commerce Clause authority to grant the States that "ability to restrict the flow of interstate commerce that they would not otherwise enjoy," Lewis v. BT Investment Managers, Inc., 447 U.S. 27, 44 (1980), States may not exercise such regulatory powers unless Congress has expressly stated its intention to make such an affirmative grant of power. New England Power Co. v. New Hampshire, 55 U.S. 331, 343 (1982).

contract path for a particular power or transmission sale crosses state lines, but rather follows the physical flow of electricity. Because of the highly integrated nature of the electric system, this results in most transmission of electric energy being "in interstate commerce.

For example, in *Jersey Central Power & Light Co. v. FPC*, 319 U.S. 61 (1943), the Court stated:

> It is impossible for us to conclude that this definition [of transmission in interstate commerce] means less than it says and applies only to the energy at the instant it crosses the state line and so only to the facilities which cross the line and only to the company which owns the facilities that cross the line.

319 U.S. at 71. Thus, a critical question regarding the jurisdictional status of a wheeling transaction is whether the facilities used to provide the service transmit electric energy in interstate commerce. *See also Connecticut Light & Power Co. v. FPC*, 324 U.S. 515 (1945) (CL&P); *FPC v. Florida Power & Light Co.*, 404 U.S. 453 (1972). In *CL&P*, the Court emphasized that whether certain facilities transmit electric energy in interstate commerce is more a technical than a legal question. The Court stated, "[f]ederal jurisdiction was to follow the flow of electric energy, an engineering and scientific, rather than a legalistic or governmental, test." 324 U.S. at 529.

In all of the above cases, the Court's decisions turned on whether energy flowed in interstate commerce as a technical matter. The decisions did not turn on whether the energy flowing in interstate commerce was being sold for

resale or was being sold to an end user. However, under FPA section 201(b), the Commission does not have jurisdiction over facilities used in local distribution. In *CL&P*, the Court stated that local distribution facilities are exempt from Commission jurisdiction even if those facilities "carry no energy except extra-state energy." 324 U.S. at 531. The Court rejected the argument that transmission and local distribution facilities could be distinguished by the proportion or amount of interstate energy that they carried:

> We do not find that Congress has conditioned the jurisdiction of the Commission upon any particular volume or proportion of interstate energy involved, and we do not think it would be appropriate to supply such a jurisdictional limitation by construction.

324 U.S. at 536. The determination of whether facilities are local distribution facilities remains a factual matter to be decided in the first instance by the Commission. *See FPC v. Southern California Edison Co.*, 376 U.S. 205 (1964).

While the precise demarcation between transmission and local distribution remains unclear, and the Commission has not yet definitively addressed this issue, there is nothing in the statute, its legislative history, or the case law to indicate that the Commission's jurisdiction over rates, terms and conditions of transmission in interstate commerce extends only to **[35,285]** wholesale transmission and not retail transmission.

(ii) Treatment of Retail Costs

Because the Commission has jurisdiction over the rates, terms and conditions of both wholesale and retail transmission services in interstate commerce by public utilities, arguably it may allow retail stranded cost recovery in rates for either wholesale or retail transmission services. There nevertheless may be important legal or policy reasons to exclude retail stranded costs from transmission rates. As noted earlier, however, the Commission has been presented only with the question of whether it should permit public utilities to seek recovery in *wholesale* transmission rates of stranded investment costs incurred to serve former retail customers (Scenario 2, section III.A.). The Commission has not been presented with the question of whether it should permit public utilities to seek recovery in *retail* transmission rates of stranded costs incurred to serve the customer when it was a retail customer (Scenario 3, section III.A.).

While we believe the Commission has the authority to address retail stranded costs through its jurisdiction over the rates, terms and conditions of interstate transmission services used by retail or newly-created wholesale customers, we also believe that the recovery of the costs of transition to competition at the retail level is a matter that should be addressed by State authorities. This is because retail stranded costs will occur primarily as a result of State and local decisionmaking regarding retail franchise areas and the creation of new wholesale entities. In particular, the Commission believes it is incumbent upon states to deal with the consequences of stranded costs that occur as a result of retail wheeling. Our strong policy preference is that states explicitly address the issue. State and local decisionmakers

have a first-hand understanding of the regulatory bargain with respect to stranded costs incurred to serve retail customers, and they are familiar with the planning, investment and purchase activities of the utilities they regulate.

There are a number of procedural mechanisms which we believe States can use to address retail stranded costs. For example, a State that permits a retail franchise customer to become a wholesale entity may consider whether to impose an exit fee prior to, or as a condition of, creating the wholesale entity. Similarly, a State may consider whether to require payment of an exit fee prior to a franchise customer being permitted to obtain unbundled retail wheeling. In situations in which local distribution facilities are used by a retail wheeling customer, the State may consider whether to allow recovery of stranded costs through rates for local distribution services. If a State decides not to impose exit fees, or a surcharge through distribution rates, it may consider whether to allow recovery of stranded costs from remaining customers.

In situations in which a new wholesale entity obtains ownership or control of a franchise utility's transmission or distribution facilities, it is possible that State condemnation proceedings will provide a forum for a utility to seek recovery of any stranded costs. *What types of payments, if any, do new municipal utilities make to prior service providers? Do these reimbursements allow for recovery of stranded generation costs? Is there variation among the States as to the legal ability of local entities to municipalize? Is there variation among the States as to the payments made by new municipal utilities to previous suppliers?*

There may, of course, be other mechanisms which States can use to determine whether to allow stranded cost recovery, and from whom to allow recovery. *The Commission solicits comments on what other mechanisms might be used, and whether these mechanisms are adequate to deal with retail stranded costs.*

While our strong preference is for States to address retail stranded costs in whatever way they deem appropriate, we are willing to explore whether there are circumstances under which this Commission should consider claims for recovery of retail stranded costs. *We will therefore present two proposed alternatives regarding retail stranded costs, and seek comment on both.* However, as noted above, we express no preference in favor of either alternative.

Under the first alternative, the proposed rule provides that if in a specific circumstance an appropriate State authority explicitly considers and deals with retail stranded costs and there is no conflict within or among State regulatory bodies regarding a State's disposition of the issue, this Commission will not entertain a request for retail stranded cost recovery. However, in the absence of a clear expression by an appropriate State authority that it has dealt with the issue, or in the event of a conflict between States[60] or among State

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[60]For example, a conflict between States could result if State A's legislature allows a former retail customer to become a wholesale entity and the wholesale entity obtains transmission services so that it now takes only one half of its 100 MW load from its current utility supplier, which is a multistate utility. As a result of State A's action, the utility has retail stranded costs for 50 MW of generation. State A's commission allocates the utility's retail

officials within a single state, the Commission proposes to entertain requests to recover retail stranded costs.

Under the second alternative, the proposed rule provides that the Commission will not entertain any request for recovery of retail stranded costs. Under this proposal, State or local authorities will be the only forum for addressing the issue. The aforementioned preference for States to address retail stranded costs in whatever way they deem appropriate, the need for regulatory certainty, and the States' knowledge and expertise regarding utility planning, investment and purchase activities arguably favors the second alterative. *However, we solicit comment on whether there should be limited exceptions to the second alternative rule.*

As to both alternatives, the Commission solicits comments on the following questions.

Are there circumstances under which it is not necessarily appropriate to defer to the States (e.g., where one State takes an action regarding retail stranded costs which has adverse consequences for another State)? Are there circumstances under which a State may not have an adequate mechanism for addressing retail stranded costs, and may want the Commission to provide a forum?

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costs so that State A's retail customers are responsible for only one half of the stranded costs. State B's commission, the other State in which the utility operates, allocates the utility's retail costs so that none of the retail stranded costs are allocated to State B's retail customers.

If a State does not explicitly address stranded costs resulting from an action that allows retail customers to purchase from a supplier other than the franchised utility, should this Commission entertain requests from the utilities left with the stranded costs? Beyond silence from the State, are there other factors that the Commission should consider before accepting requests for retail stranded cost recovery? Specifically, would financial health and possible adverse impacts on reliability be sufficient reason for Federal action?

The Commission further solicits comments on the following questions:

(1) Does the Commission have legal authority to allow retail stranded costs in rates for wholesale transmission services? Should the Commission do so as a matter of policy? If so, which costs?

(2) Does the Commission have legal authority to allow retail stranded costs **[35,286]** *in rates for retail transmission service? Should the Commission do so as a matter of policy? If so, which costs?*

(3) Does FPA section 212 give the Commission legal authority to allow recovery of retail stranded costs in rates for wholesale transmission services under FPA section 211?

(4) Are there legal or policy reasons why in Scenario 2 (p. 15), the Commission should entertain requests for recovery of retail stranded costs in wholesale transmission rates, but should not entertain requests for recovery of retail stranded costs in retail transmission rates in Scenario 3 (section III.A.)?

If the Commission determines that it will entertain requests for recovery of retail stranded costs through rates for wholesale or retail transmission in interstate commerce, the Commission proposes not to apply the "reasonable expectation" test used for wholesale stranded costs. To apply such a test would require a hearing on whether the franchise utility had a reasonable expectation, *e.g.*, of having its franchise renewed, of municipalization occurring, or of a section 212(h) non-sham wholesale entity being created by the State or local authority. No such test appears warranted because, in general, there is at the retail level an obligation to serve which is much stronger than any contractual obligation to serve at the wholesale level. The regulatory compact that has governed provision of retail service includes an implicit obligation to purchase concomitant with the utility's obligation to serve.

The Commission requests comments on whether these assumptions are correct, i.e., is the reasonable expectation test inapplicable to retail stranded costs? Are there situations, for instance, in which utilities could have expected municipalization to occur based on an established course of dealing?

Based on these assumptions, if the Commission determines that it will entertain requests for retail stranded costs, the proposed regulations for retail stranded costs would require only a showing of the dollar amounts that have been stranded as a result of the retail customer no longer taking bundled service from the franchise utility's system. In essence, this results in direct assignment of retail stranded costs to the former franchise customer. *The Commission requests comments on how to determine retail stranded costs*

as a general matter. Is there a future time when a retail customer's action of leaving a local franchise no longer has any adverse economic consequences on the franchise utility? If so, what is an appropriate way to make such a determination?

[pp. 1-4]

Comments of North Carolina Utilities Commission and the Public Staff of the North Carolina Utilities Commission

Designated Pages - 1-4, 6-7

[2]

COMMENTS OF THE
NORTH CAROLINA UTILITIES COMMISSION
AND THE
PUBLIC STAFF - NORTH CAROLINA UTILITIES COMMISSION

TO THE

FEDERAL ENERGY REGULATORY COMMISSION

REGARDING

NOTICE OF PROPOSED RULEMAKING AND
SUPPLEMENTAL
NOTICE OF PROPOSED RULEMAKING

DOCKET NO. RM95-8-000
PROMOTING WHOLESALE COMPETITION
THROUGH OPEN ACCESS NON-DISCRIMINATORY
TRANSMISSION SERVICES BY PUBLIC UTILITIES

DOCKET NO. RM94-7-00 l
RECOVERY OF STRANDED COSTS BY
PUBLIC UTILITIES AND TRANSMITTING UTILITIES

[3]

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

[Filed August 10, 1995]

Docket Nos. RM95-8-000 and RM94-7-001

Promoting Wholesale Competition	)
Through Open Access	)
Non-discriminatory Transmission	)
Services by Public Utilities	)
	)
Recovery of Stranded Costs by	)
Public Utilities and Transmitting	)
Utilities	)
	)

INITIAL COMMENTS OF THE NORTH CAROLINA UTILITIES COMMISSION AND THE PUBLIC STAFF-NORTH CAROLINA UTILITIES COMMISSION

The North Carolina Utilities Commission (NCUC) and the Public Staff of the North carolina Utilities Commission (Public Staff) respectfully offer the following comments for consideration by the Federal Energy Regulatory Commission (FERC) in its proposed rulemaking in Docket Nos. RM95-8-000 and RM94-7-001 regarding open access to the electric transmission system and the recovery of stranded costs occasioned by open *access*.

1. OPEN ACCESS SHOULD BE APPROACHED ON A CASE-BY-CASE BASIS.

The NCUC and the Public Staff are concerned that the FERC is proposing a generic remedy for a less-than-generic problem. The FERC position that the anti-discrimination provisions of the Federal Power Act (FPA) require across-the-board tariffs for open access to the electric transmission system of every utility is misguided. We recognize that the FERC and various states may disagree about whether a generic approach to open access is legal.[1] Nevertheless, even assuming that such an approach is legal, we believe that a case-by-case approach to open access would be far preferable from a policy standpoint for a number of reasons.

Discriminatory wholesale wheeling rates and discriminatory denial of wholesale access to the electric, utilities' transmission systems vary greatly among the states and are simply not consistently present to the extent necessary to justify a generic approach to open access. The NCUC is unaware of complaints to the FERC by any wholesale customer regarding discriminatory denial of access to **[3]** or of discriminatory rates for use of the transmission system in North Carolina. The absence of such complaints strongly

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[1]This legal argument, as we understand it, is based on the fact that § 211 of the FPA, 16 U.S.C. § 824j, as amended by § 721 of the Energy Policy Act of 1992 (the source of the FERC's authority to order wholesale wheeling) provides that the FERC can order a transmitting utility to provide transmission service upon application and after notice and an opportunity for an evidentiary hearing. We will be monitoring with great interest the comments of others with respect to this issue.

suggests that discrimination is not a problem in North Carolina.

If anything, the generic open access proposal by the FERC has the potential to cause undue discrimination where none existed before. For example, the electric transmission system of each utility is interconnected with neighboring transmission systems in order to ensure greater reliability. However, this interconnection exposes each transmission system to greater loop flows.[2] Open access will greatly complicate loop flows by increasing the number of participants contributing to such loop flows, and it will also cause an unfairly disproportionate burden of dealing with the impact of loop flows to fall on many utilities that are not direct participants in an open access wheeling transaction.

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[2]As the FERC is well aware, the actual path taken by electric power flow across a transmission system is difficult to predict. Because of its interconnection with neighboring systems, a transmission system typically consists of a number of possible paths between any two points.. Electric current essentially flows on a path of least resistance. An electric load placed on the transmission system will usually cause electric current to flow in all possible paths, but the amount of flow in each path will vary depending on the amount of resistance to flow in a given path. The resulting circuitous route (or mutes) that electric current actually takes in order for electric power to be transferred between two points is called loop flow. In sum, the actual flow of electricity typically diverges significantly from the contract path, with the result that the supposed economics of the contract path frequently have little to do with the actual cost of the power transfer.

Section 211 of the Federal Power Act, as mended by the Energy Policy Act of 1992 (EPACT), provides that an electric utility, power marketing agency or non-utility generator may apply to the FERC for an order requiring access to the electric transmission system ora transmitting utility (including enlargement of transmitting capacity as necessary). Thus, the EPACT clearly contemplates the ordering of wholesale wheeling **upon request**. We believe this reflects a congressional intent for wholesale wheeling to be required on a case-by-case basis and that the FERC should review issues of "undue discrimination" on a case-by-case basis as intended by the EPACT.

The FERC's current generic approach to pricing may well inhibit greater competition in the wholesale generation market. The FERC's authority to require new transmission facilities to be built, for example, is dependent upon the states granting authority for the new facilities to be constructed. Because the granting of a certificate by a state commission for the construction of transmission facilities could well preclude that commission from disallowing recovery in retail rates, many states may be reluctant to grant such authority with little or no assurance that retail ratepayers will not be required by default to carry a disproportionate share of the costs. Of substantial concern in this regard is the fact that many utilities appear to be unwilling to challenge the FERC's authority and/or its determinations with regard to open access because such action is perceived as endangering approval of market based rates for affiliated generating companies. Obviously, to the extent transmission costs are not recovered by the users of the transmission system, there is a danger that the utilities' captive retail ratepayers will end up covering these costs.

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[pp. 6-7]

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3. EACH UTILITY'S GENERATING CAPACITY EXPANSION PLAN REFLECTS AN OBLIGATION TO SERVE THAT TRANSCENDS ITS CONTRACTUAL OBLIGATIONS TO CUSTOMERS.

The NCUC and the Public Staffare concerned about the negative impact that open access to the electric transmission system will have on each utility unless its obligation to serve its wholesale customers is waived. State regulators have charged each utility with an obligation to serve at the retail level in their respective states, and the FERC has created a "de facto" obligation to serve at the wholesale level.

The obligation to serve is reflected in each utility's generating capacity expansion plan, and it transcends any contractual obligation the utility may incur with a customer at either the retail level or the wholesale level. Any "reasonable expectation" that a wholesale customer will remain on a utility's system for the duration of the cost to serve that customer is based on the utility's "de facto" obligation to serve and the resulting generating capacity expansion plan. Until the obligation to serve wholesale customers is clarified, the NCUC and other state commissions will have little choice but to require each utility's integrated resource planning to include the assumption that the obligation to serve extends past the expiration date of its wholesale contracts.

Mandatory wholesale wheeling and a utility's obligation to serve wholesale customers are inconsistent with each other. The obligation to serve arises from a utility's monopoly status. If open access to the electric transmission system is required for wholesale customers in order to promote greater competition, then a utility's obligation to serve them must be waived. Otherwise, the utilities are under a handicap and true competition cannot exist. We urge the FERC to recognize this inconsistency.

4. THE DIVISION OF JURISDICTION BETWEEN THE FERC AND THE STATES IN THE OPEN ACCESS PROPOSED RULEMAKING IS NOT SUPPORTED BY THE FPA OR BY CASE LAW.

The NCUC and the Public Staff are concerned that the division of jurisdiction between the FERC itself and the states in the open access proposed rulemaking is not supported by the FPA or the relevant case law. The FERC open access proposal contains the assertion that the FERC has jurisdiction over all transmission facilities, on the assumption that all transmission facilities are interconnected with neighboring transmission systems and are, therefore, directly or indirectly used [7] to serve wholesale customers. While it is generally recognized that the FERC has jurisdiction over transmission facilities serving wholesale customers and over transmission facilities used for inter-utility transactions, the FISA and the case law provide that the FERC has no jurisdiction over facilities used in local distribution. Local distribution facilities have been defined as facilities used to deliver electric energy to the ultimate consumer. Therefore, because retail customers in many instances are served directly off the transmission

system, transmission facilities can be facilities used in local distribution.

Open access to the transmission facilities that directly serve retail customers will invite sham transactions and sham municipalization by those transmission level retail customers seeking to become wholesale customers and thereby gain access to wholesale wheeling. This is an issue that is certain to invite litigation and potentially delay true wholesale open access. An example of this is the case involving Falls Church, Virginia, and Virginia Electric & Power Company. The NCUC and the Public Staff believe that the FERC has underestimated the creativity with which those individuals who are consultants to large retail customers will approach this issue. A significant cottage industry may well arise solely to convert retail customers into wholesale customers, thereby subverting the intent of Congress as expressly set forth in EPACT.

FEDERAL ENERGY REGULATORY COMMISSION
ORDER 888

[Issued April 24, 1996]

Docket Nos. RM95-8-000 and RM94-7-001

Order No. 888

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[pp. 31,632 - 31,684]

[31,036]
61 F.R. 21540 (May 10, 1996)

18 CFR Parts 35 and 385

Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities

AGENCY: Federal Energy Regulatory Commission, DOE.

ACTION: Final Rule.

SUMMARY: The Federal Energy Regulatory Commission (Commission) is issuing a Final Rule requiring all public utilities that own, control or operate facilities used for transmitting electric energy in interstate commerce to have on file open access non-discriminatory transmission tariffs that contain minimum terms and conditions of non-discriminatory service. The Final Rule also permits public utilities and transmitting utilities to seek recovery of legitimate, prudent

and verifiable stranded costs associated with providing open access and Federal Power Act section 211 transmission services. The Commission's goal is to remove impediments to competition in the wholesale bulk power marketplace and to bring **[31,633]** more efficient, lower cost power to the Nation's electricity consumers.

EFFECTIVE DATE: This Final Rule will become effective on July 9, 1996.

FOR FURTHER INFORMATION CONTACT: David D. Withnell (Legal Information -- Docket No. RM95-8-000) Office of the General Counsel Federal Energy Regulatory Commission 888, First Street, NE., Washington, DC 20426 (202) 208-2063

Deborah B. Leahy (Legal Information -- Docket No. RM94-7-001) Office of the General Counsel Federal Energy Regulatory Commission, 888 First Street, NE., Washington, DC 20426 (202) 208-2039

Michael A. Coleman (Technical Information) Office of Electric Power Regulation Federal Energy Regulatory Commission 888, First Street, NE., Washington, DC 20426 (202) 208-1236

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I. Introduction/Summary

Today the Commission issues three final, interrelated rules designed to remove impediments to competition in the wholesale bulk power marketplace and to bring more efficient, lower cost power to the Nation's electricity consumers.[1] The legal and policy cornerstone of these rules is to remedy undue discrimination in access to the monopoly owned transmission wires that control whether and to whom electricity can be transported in interstate commerce. A second critical aspect of the **[31,635]** rules is to address recovery of the transition costs of moving from a monopoly-regulated regime to one in which all sellers can compete on a fair basis and in which electricity is more competitively priced.

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[1]These rules are the rules on open access and stranded costs in the above dockets (*FERC Statutes and Regulations* ¶31,036), and an accompanying rule on Open Access Same-Time Information System and Standards of Conduct (OASIS Final Rule) (*FERC Statutes and Regulations* ¶31,037) being issued contemporaneously. The Commission also is issuing contemporaneously a notice of proposed rulemaking on capacity reservation open access transmission tariffs in Docket No. RM96-11-000, *FERC Statutes and Regulations* ¶32,517. These final rules and proposed rule are being published concurrently in the *Federal Register*.

In the year since the proposed rules were issued,[2] the pace of competitive changes in the electric utility industry has accelerated. By March of last year, 38 public utilities had filed wholesale open access transmission tariffs with the Commission. Today, prodded by such competitive changes and encouraged by our proposed rules, 106 of the approximately 166 public utilities that own, control, or operate[3] transmission facilities used in interstate commerce have filed some form of wholesale open access tariff. In addition, since the time the proposed rules were issued, numerous state regulatory commissions have adopted or are

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[2]On March 29, 1995, the Commission issued two notices of proposed rulemaking concerning open access transmission and stranded cost recovery. Promoting Wholesale Competition Through Open-Access Non-Discriminatory Transmission Service by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Notice of Proposed Rulemaking and Supplemental Notice of Proposed Rulemaking, 60 FR 17662 (April 7, 1995), *FERC Statutes and Regulations* ¶32,514 (1995). On December 13, 1995, the Commission issued a notice of proposed rulemaking on information systems. Real- Time Information Networks and Standards of Conduct, Notice of Proposed Rulemaking, 60 FR 66182 (December 21, 1995), *FERC Statutes and Regulations* ¶32,516 (1995).

[3]The Commission's notice of proposed rulemaking in the above dockets proposed to apply the proposed requirements to public utilities that own and/or control facilities used for the transmission of electric energy in interstate commerce. "Own and/or control" is intended to include public utilities that "operate" facilities used for the transmission of electric energy in interstate commerce. However, we have modified the Final Rule regulatory text to remove any ambiguity.

actively evaluating retail customer choice programs or other utility restructuring alternatives. These events have been spurred by continuing pressures in the marketplace for changes in the way electricity is bought, sold, and transported. Increasingly, customers are demanding the benefits of competition in the growing electricity commodity market.

The Commission estimates the potential quantitative benefits from the Final Rule will be approximately $3.8 to $5.4 billion per year of cost savings, in addition to the non-quantifiable benefits that include better use of existing assets and institutions, new market mechanisms, technical innovation, and less rate distortion. The continuing competitive changes in the industry and the prospect of these benefits to customers make it imperative that this Commission take the necessary steps within its jurisdiction to ensure that all wholesale buyers and sellers of electric energy can obtain non-discriminatory transmission access, that the transition to competition is orderly and fair, and that the integrity and reliability of our electricity infrastructure is maintained.

In this Rule, the Commission seeks to remedy both existing and future undue discrimination in the industry and realize the significant customer benefits that will come with open access. Indeed, it is our statutory obligation under sections 205 and 206 of the Federal Power Act (FPA) to remedy undue discrimination.

To do so, we must eliminate the remaining patchwork of closed and open jurisdictional transmission systems and ensure that all these systems, including those that already provide some form of open access, cannot use monopoly

power over transmission to unduly discriminate against others. If we do not take this step now, the result will be benefits to some customers at the expense of others. We have learned from our experience in the natural gas area the importance of addressing competitive transition issues early and with as much certainty to market participants as possible.

Accordingly, in this proceeding and in the accompanying proceeding on OASIS, the Commission, pursuant to its authorities under sections 205 and 206 of the FPA:

•Requires all public utilities that own, control or operate facilities used for transmitting electric energy in interstate commerce

•To file open access non-discriminatory transmission tariffs that contain minimum terms and conditions of non-discriminatory service;

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•To take transmission service (including ancillary services) for their own new wholesale sales and purchases of electric energy under the open access tariffs;

•To develop and maintain a same-time information system that will give existing and potential transmission users the same access to transmission information that the public utility enjoys, and further requires public utilities to separate transmission from generation marketing functions and communications;

•Clarifies Federal/state jurisdiction over transmission in interstate commerce and local distribution and provides for deference to certain state recommendations; and

•Permits public utilities and transmitting utilities to seek recovery of legitimate, prudent and verifiable stranded costs associated with providing open access and FPA section 211 transmission services.

Open Access

The Final Rule requires public utilities to file a single open access tariff that offers both network, load-based service and point-to-point, contract-based service. The Rule contains a pro forma tariff that reflects modifications to the NOPR's proposed terms and conditions and also permits variations for regional practices. All public utilities subject to the Rule, including those that already have tariffs on file, will be required to make section 206 compliance filings to meet the new pro forma tariff non-price minimum terms and conditions of non-discriminatory transmission. Utilities may propose their own rates in a section 205 compliance filing.

The Rule provides that public utilities may seek a waiver of some or all of the requirements of the Final Rule. In addition, non-public utilities may seek a waiver of the tariff reciprocity provisions.

The Final Rule does not generically abrogate existing requirements contracts, but will permit customers and public utilities to seek modification, or termination, of certain existing requirements contracts on a case-by-case basis. As to coordination arrangements and contracts, the Rule finds that

these arrangements and contracts may need to be modified to remove unduly discriminatory transmission access and/or pricing provisions. Such arrangements and agreements include power pool agreements, public utility holding company agreements, and certain bilateral coordination agreements. The Rule provides guidance and timelines for modifying unduly discriminatory coordination arrangements and contracts, and specifies when the members of such arrangements must begin to conduct trade with each other using the same open access tariff offered to others. The Rule also provides guidance regarding the formation of independent system operators (ISOs).

The Rule does not require any form of corporate restructuring, but will accommodate voluntary restructuring that is consistent with the Rule's open access and comparability policies.

As discussed in the NOPR, not all owners or controllers of interstate transmission facilities are subject to the Commission s jurisdiction under sections 205 and 206 of the FPA and therefore are not subject to this Rule's open access requirements. Therefore, the Final Rule retains the proposed reciprocity provision in the pro forma tariff. Without such a provision, non-open access utilities could take advantage of the competitive opportunities of open access, while at the same time offering inferior access, or no access at all, over their own facilities. Thus, open access utilities would be unfairly burdened. We note that some non-jurisdictional utilities have expressed an interest in a mechanism for obtaining a Commission determination that their transmission tariffs satisfy the reciprocity provisions in

the pro forma tariffs, and we provide such a mechanism in the Rule.

The Final Rule does not generically provide for market-based generation rates. Although the Rule codifies the Commission's prior decision that there is no generation dominance in new generating capacity, intervenors in cases may raise generation dominance issues related to new capacity. In addition, to obtain market-based rates for existing generation, we will continue to require public utilities to show, on a case-by-case basis, that there is no generation dominance in existing capacity. Further, in all market-based rate cases, we will continue to look at whether an applicant and its affiliates could erect other barriers to entry and **[31,637]** whether there may be problems due to affiliate abuse or reciprocal dealing.

Finally, contemporaneously with this Rule the Commission issues a NOPR on capacity reservation tariffs as an alternative, and perhaps superior, means of remedying undue discrimination.

Transmission/Local Distribution

The Rule clarifies the Commission's interpretation of the Federal/state jurisdictional boundaries over transmission and local distribution. While we reaffirm our conclusion that this Commission has exclusive jurisdiction over the rates, terms, and conditions of unbundled retail transmission in interstate commerce by public utilities, we nevertheless recognize the very legitimate concerns of state regulatory authorities as they contemplate direct retail access or other state restructuring programs. Accordingly, we specify

circumstances under which we will give deference to state recommendations. Although jurisdictional boundaries may shift as a result of restructuring programs in wholesale and retail markets, we do not believe this will change fundamental state regulatory authorities, including authority to regulate the vast majority of generation asset costs, the siting of generation and transmission facilities, and decisions regarding retail service territories. We intend to be respectful of state objectives so long as they do not balkanize interstate transmission of power or conflict with our interstate open access policies.

Stranded Costs

With regard to stranded costs, the Final Rule adopts the Commission's supplemental proposal. It will permit utilities to seek extra-contractual recovery of stranded costs associated with a limited set of existing (executed on or before July 11, 1994) wholesale requirements contracts and provides that the Commission will be the primary forum for utilities to seek recovery of stranded costs associated with retail-turned-wholesale transmission customers. It also will allow utilities to seek recovery of stranded costs caused by retail wheeling only in circumstances in which the state regulatory authority does not have authority to address retail stranded costs at the time the retail wheeling is required. The Rule retains the revenues lost approach for calculating stranded costs and provides a formula for calculating such costs.

Environmental Issues

The Commission has prepared a Final Environmental Impact Statement (FEIS) evaluating the possible

environmental consequences of changes in the bulk power marketplace expected to occur as a result of the open access requirements of this Final Rule. The FEIS focuses, as do most commenters, on possible increases in emissions of nitrogen oxides (NO/X/) from certain fossil-fuel fired generators, which could affect air quality in the producing region and in areas to which these emissions may be carried.

In response to comments on the Draft EIS, the Commission performed numerous additional studies. The FEIS finds that the relative future competitiveness of coal and natural gas generation is the key variable affecting the impact of the Final Rule. If competitive conditions favor natural gas, the Rule is likely to lead to environmental benefits. Both EPA and the Commission staff believe this projected scenario is the more likely one. If competitive conditions favor coal, the Rule may lead to small negative environmental impacts. However, even using the most extreme, unlikely assumptions about the future of the industry, the negative consequences are not likely to occur until after the turn of the century. Because the impacts will remain modest at least until 2010, there is no need for an interim mitigation program. In addition, even if the data showed more significant negative consequences requiring mitigation, the Commission does not have the statutory authority under the Federal Power Act or the expertise to address this possible far- term problem. The Commission believes, however, that there is time for federal and state air quality authorities to address any potential adverse impact as part of a comprehensive NO_x regulatory program under the Clean Air Act.[4]

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[4]42 U.S.C. §7401, et seq.

Despite our conclusions regarding the lack of environmental impacts expected to result from the Rule, the Commission has examined a wide variety of proposals for mitigating possible adverse effects. We share the view of most commenters **[31,638]** that the preferred approach for mitigating increased NO/X/ emissions generally is a NO/X/ cap and trading regulatory program comparable to that developed by Congress to address sulfur dioxide emissions in the Clean Air Act Amendments of 1990.[5] The Commission has examined various means of establishing such a program, including use of existing federal authorities under the Clean Air Act, cooperative efforts by state and federal air quality regulators, and development of a new emissions regulatory program administered by the Commission under the Federal Power Act. The Commission has concluded that a NO/X/ regulatory program could best be developed and administered under the Clean Air Act, in cooperation with interested states, and offers to lend Commission support to that effort should it become necessary.

Conclusion

The Commission believes that the Final Rule will remedy undue discrimination in transmission services in interstate commerce and provide an orderly and fair transition to competitive bulk power markets.

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[5]42 U.S.C.A. §7651b-e.

II. Public Reporting Burden

The Open Access Final Rule and the Stranded Cost Final Rule specify filing requirements to be followed by public utilities that own, control or operate transmission facilities in interstate commerce in making non-discriminatory open access tariff filings and filings to recover legitimate, prudent and verifiable stranded costs. The information collection requirements of the final rules are attributable to FERC-516 "Electric Rate Filings." The current total annual reporting burden for FERC-516 is 828,300 hours.

A. *Docket No. RM95-8-000 (Open Access Final Rule)*

The Open Access Final Rule requires public utilities filing non-discriminatory open access tariffs to provide certain information to the Commission. The Commission estimated that the public reporting burden for the information collection would average 300 hours per response. This estimate included time for reviewing the requirements of the Commission's regulations, searching existing data sources, gathering and maintaining the necessary data, completing and reviewing the collection of information, and filing the revised information. No comments on the burden estimate were received. Because the Final Rule adopts essentially the same information requirements that are contained in the proposed rule, we believe that the average filing burden is same for the Final Rule.

In the proposed rule, the Commission noted that there are approximately 328 public utilities, including marketers and wholesale generation entities. We initially estimated that 137 public utilities own, control or operate facilities used for

the transmission of electric energy in interstate commerce, and would be subject to the filing requirements of the proposed rule. Upon further review, the Commission believes that approximately 166 public utilities will respond to the information collection. Accordingly, the public reporting burden is estimated to be 49,800 hours.

B. *Docket No. RM94-7-001 (Stranded Cost Final Rule)*

In the supplemental notice of proposed rulemaking, the Commission estimated that the information requirements of the proposed rule would not differ substantially from those contained in the initial proposed rule. In that notice, the Commission estimated that the public reporting burden for the information requirements contained in the proposed rule would be 50 hours per response with 10 responses annually. No comments on this filing burden were received. The information requirements adopted in the Stranded Cost Final Rule are not substantially different from those in the proposed rule. Therefore, the Commission concludes that there will be no additional public filing burden associated with the Stranded Cost Final Rule.

III. Background

In the NOPR, we set out a detailed statement of the events leading up to this rulemaking. We repeat that background here, updated to reflect what has happened since March 1995, and discuss why it is necessary to undertake regulatory reform in the electric industry at this time. We do so to provide the necessary **[31,639]** backdrop to our action in adopting this Rule.

A. *Structure of the Electric Industry at Enactment of Federal Power Act*

The Federal Power Act was enacted in an age of mostly self-sufficient, vertically integrated electric utilities, in which generation, transmission, and distribution facilities were owned by a single entity and sold as part of a bundled service (delivered electric energy) to wholesale and retail customers. Most electric utilities built their own power plants and transmission systems, entered into interconnection and coordination arrangements with neighboring utilities, and entered into long-term contracts to make wholesale requirements sales (bundled sales of generation and transmission) to municipal, cooperative, and other investor-owned utilities (IOUs) connected to each utility's transmission system. Each system covered limited service areas. This structure of separate systems arose naturally due primarily to the cost and technological limitations on the distance over which electricity could be transmitted.

Through much of the 1960s, utilities were able to avoid price increases, but still achieve increased profits, because of substantial increases in scale economies, technological improvements, and only moderate increases in input prices.[6] Thus, there was no pressure on regulatory

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[6]Paul L. Joskow, Inflation and Environmental Concern: Structural Change in the Process of Public Utility Regulation, 17 J. Law & Econ. 291, 312 (1974); *see also* Charles F. Phillips, Jr., *The Regulation of Public Utilities* 11 (1988).

commissions to use regulation to affect the structure of the industry.[7]

B. *Significant Changes in the Electric Industry*

In the late 1960s and throughout the 1970s, a number of significant events occurred in the electric industry that changed the perceptions of utilities and began a shift to a more competitive marketplace for wholesale power.[8] This was the beginning of periods of rapid inflation, higher nominal interest rates, and higher electricity rates.[9] During this time, consumers became concerned about higher electricity rates and questioned any price increases filed by utilities.[10]

During this same time frame, the construction of nuclear and other capital-intensive baseload facilities--actively encouraged by federal and some state governments--contributed to the continuing cost increases and uncertainties

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[7]*See* Joskow, *supra* at p. 312; *see also* Phillips, *supra* at p. 12.

[8]*See* Joskow, *supra* at p. 312; *see also* Phillips, *supra* at pp. 12-13.

[9]*See* Joskow, *supra* at pp. 312-13; *see also* Phillips, supra at p. 13. The Arab oil embargo resulted in significantly higher oil prices through the 1970s. *See* Richard J. Pierce, Jr., The Regulatory Treatment of Mistakes in Retrospect: Canceled Plants and Excess Capacity, 132 U. Pa. L. Rev. 497, 501 (1984).

[10]*See* Joskow, *supra* at p. 313; *see also* Phillips, *supra* at p. 13.

in the industry.[11] These investments were made based on the assumptions that there would be steady increases in the demand for electricity and continued large increases in the price of oil.[12] However, due to conservation and economic downturns, the expected demand increases did not materialize. Load growth virtually disappeared in some areas, and many utilities unexpectedly found themselves with excess capacity.[13] In addition, by the 1980s, the oil cartel collapsed, with a resulting glut of low-priced oil.[14] At the same time, inflation substantially increased the costs of these large baseload generating plants.[15] Surging interest rates further increased the cost of the capital needed to finance and capitalize these projects and completion schedules were

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[11]*See generally Jersey Central Power & Light Company v. FERC*, 810 F.2d 1168, 1171 (D.C. Cir. 1987).

[12]*Id.*

[13]*See* Pierce, *supra* at 503. By 1983, the Department of Energy had estimated that the sunk costs for canceled nuclear plants alone amounted to $10 billion. *Id.* at 498.

[14]*Id.*

[15]*See* Bernard S. Black & Richard J. Pierce, Jr., The Choice Between Markets and Central Planning in Regulating the U.S. Electricity Industry, 93 Col. L. Rev. 1339, 1346 (1993) ("Actual costs of nuclear power plants vastly exceeded estimates, sometimes by as much as 1000%.").

significantly **[31,640]** extended by, in part, more stringent safety and environmental requirements.[16]

As a result, expensive large baseload plants for which there was little or no demand, came onto the market or were in the process of being constructed. Accordingly, between 1970 and 1985, average residential electricity prices more than tripled in nominal terms, and increased by 25% after adjusting for general inflation.[17] Moreover, average electricity prices for industrial customers more than quadrupled in nominal terms over the same period and increased 86% after adjusting for inflation.[18] The rapidly increasing rates for electric power during this period, together with the opportunities provided by the Public Utility Regulatory

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[16]*See* Phillips, *supra* at p. 13. Fossil fuel-fired plants became subject to increased regulation as a result of the Clean Air Act of 1970, and its 1977 amendments. 42 U.S.C. §§7401-7642. In 1971, nuclear plant licensing became subject to the environmental impact statement requirements of the National Environmental Policy Act of 1969. 42 U.S.C. §4332. Following the 1979 accident at the Three Mile Island nuclear plant, nuclear plants also became subject to additional safety regulations, resulting in higher costs. *See* Energy Information Administration, *The Changing Structure of the Electric Power Industry 1970-1991* (March 1993) 35. Between 1976 and 1980, most states and many localities instituted laws governing power plant siting.

[17]Based on retail prices reported in Energy Information Administration (EIA), Monthly Energy Review, January 1995, Table 9.9 (Prices adjusted for inflation using the GDP Deflator (1987 = 100)).

[18]*Id.*

Policies Act of 1978 (PURPA) (discussed infra), also prompted some industrial customers to bypass utilities by constructing their own generation facilities. This further exacerbated rate increases for remaining customers -- primarily residential and commercial customers.

Consumers responded to these "rate shocks" by exerting pressure on regulatory bodies to investigate the prudence of management decisions to build generating plants, especially when construction resulted in cost overruns, excess capacity, or both. Between 1985 and 1992, writeoffs of nuclear power plants totalled $22.4 billion.[19] These writeoffs significantly reduced the earnings of the affected utilities.[20] Delays in obtaining rate increases to reflect the effects of inflation further reduced investor returns. Thus, many utilities became reluctant to commit capital to long-term construction decisions involving large scale generating plants.[21]

In addition to economic changes in the industry, significant technological changes in both generation and transmission have occurred since 1935. Through the 1960s, bigger was cheaper in the generation sector and the industry was able to capitalize on economies of scale to produce power

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[19]*See* Black & Pierce, *supra* at p. 1346 (These writeoffs were "about 17% of the book value of total 1992 utility investment.").

[20]*Id.*

[21]*Id.* ("The high perceived risk of future disallowances reversed utilities' incentives to overinvest, and made utilities extremely reluctant to build new power plants.").

at lower per-unit costs from larger and larger plants.[22] As a result, large utility companies that could finance and manage construction projects of larger scale had a price advantage over smaller utility companies and customers who might otherwise have considered building their own generating units. Scale economies encouraged power generation by large vertically-integrated utility companies that also transmitted and distributed power. Beginning in the 1970s, however, additional economies of scale in generation were no longer being achieved.[23] A significant factor was that larger generation units were found to need relatively greater maintenance and experience longer downtimes.[24] The electric **[31,641]** industry faced the situation "where the price of each incremental unit of electric power exceeded the average cost."[25] Bigger was no longer better.

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[22]*See* Preston Michie, Billing Credits for Conservation, Renewable, and Other Electric Power Resources: an Alternative to Marginal-Cost-Based Power Rates in the Pacific Northwest, 13 Environmental Law 963, 964-65 (1983).

[23]*Id.* at p. 965.

[24]Energy Information Administration, *The Changing Structure of the Electric Power Industry 1970-1991* (March 1993) 37 ("As larger units were constructed, however, utilities discovered that downtime was as much as 5 times greater for units larger than 600 megawatts than for units in the 100-megawatt range.")

[25]*Id.*; *see also* George A. Perrault, Downsizing Generation: Utility Plans for the 1990s, Pub. Util. Fort. 15-16 (Sept. 27, 1990) ("The large base-load generating units that form the backbone of utility systems are almost totally absent from capacity plans for the 1990s.").

Further dictating against larger generation units were advances in technologies that allowed scale economies to be exploited by smaller size units, thereby allowing smaller new plants to be brought on line at costs below those of the large plants of the 1970s and earlier. Such new technologies include combined cycle units and conventional steam units that use circulating fluidized bed boilers.[26]

The combined cycle generating plants generally use natural gas as their primary fuel. This technology has been made possible by the development of more efficient gas turbines, shorter construction lead times, lower capital costs, increased reliability, and relatively minimal environmental impacts.[27] Similarly, the circulating fluidized bed combustion boilers, fueled by coal and other conventional fuels, provide a more efficient and less polluting resource.

Today, "the optimum size (of generation plants) has shifted from (more than 500 MW) (10-year lead time) to smaller units (one-year lead time) (in the 50- to 150-MW

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[26]"From 1982 through 1991, the average capacity of fluidized-bed units increased rapidly to 72 megawatts for 4 units in 1991. The average capacity for the 19 units planned to begin operating in 1992 through 1995 increases to 83 megawatts." Energy Information Administration, *The Changing Structure of the Electric Power Industry 1970-1991* (March 1993) 38.

[27]*See* Charles E. Bayless, Less is More: Why Gas Turbines Will Transform Electric Utilities, Pub. Util. Fort. (Dec. 1, 1994) 21.

range)."[28] Indeed, smaller and more efficient gas-fired combined-cycle generation facilities can produce power on the grid at a cost ranging from 5 cents per kWh to less than 3 cents per kWh.[29] This is significantly less than the costs for large plants constructed and installed by utilities over the last decade, which were typically in the range of 4 to 7 cents per kWh for coal plants and 9 to 15 cents for nuclear plants.[30] Significant changes have also occurred in the transmission sector of the industry. Technological advances in transmission have made possible the economic transmission of electric power over long distances at higher voltages.[31] This has made

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[28]*Id.* at p. 24. *See also* Wallace E. Brand, Is Bigger Better? Market Power in Bulk Power Supply: From FDR to NOPR, Pub. Util. Fort. (Feb. 15, 1996) 23 at p. 25 (while the optimal baseload unit size is about 500 MW for coal-fired steam turbines, the optimal size for gas fired combined-cycle units is about 150 to 200 MW).

[29]FERC staff calculations based in part on combined-cycle plant cost data reported in 1994 FERC Form No. 1 for a sample of units placed in service during 1990-94. Costs vary with regional fuel and construction costs, among other reasons.

[30]Coal and Nuclear plant cost data reported in 1994 FERC Form No. 1 and the EIA report, *Electric Plant Cost and Power Production Expenses 1991*, 1993 DOE/EIA-0455(91), for plants placed in service during 1986-94; *see also* The 1994 Electric Executives' Forum, Bakke (President and CEO of the AES Corporation), Pub. Util. Fort. (June 1, 1994) 45 ("New generation can be built at about 3 cents per kilowatt-hour (U.S. average). Old generation costs about twice that * * *").

[31]*See* Black & Pierce, *supra* at p. 1345 (In the late 1960s and 1970s, improved transmission efficiency and development of

it technically feasible for utilities with lower cost generation sources to reach previously isolated systems where customers had been captive to higher cost generation. In addition, the nature and magnitude of coordination transactions[32] have changed dramatically since enactment of the FPA, allowing increased coordinated operations and reduced reserve margins. Substantial amounts of electricity now move between regions, as well as between utilities in the same region. Physically isolated systems have become a thing of the past.

[31,642]

C. *The Public Utility Regulatory Policies Act and the Growth of Competition*

In enacting PURPA,[33] Congress recognized that the rising costs and decreasing efficiencies of utility-owned generating facilities were increasing rates and harming the

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regional transmission networks "made it possible to build power plants up to 1000 miles from power users.").

[32]Coordination transactions are voluntary sales or exchanges of specialized electricity services that allow buyers to realize cost savings or reliability gains that are not attainable if they rely solely on their own resources. For sellers, these transactions provide opportunities to earn additional revenue, and to lower customer rates, from capacity that is temporarily excess to native load capacity requirements.

[33]Pub. L. No. 95-617, 92 Stat. 3117 (codified in U.S.C. sections 15, 16, 26, 30, 42, and 43).

economy as a whole.[34] To lessen dependence on expensive foreign oil, avoid repetition of the 1977 natural gas shortage, and control consumer costs, Congress sought to encourage electric utilities to conserve oil and natural gas.[35] In particular, Congress sanctioned the development of alternative generation sources designated as "qualifying facilities" (QFs) as a means of reducing the demand for traditional fossil fuels.[36] PURPA required utilities to purchase power from QFs

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[34]*See generally FERC v. Mississippi*, 456 U.S. 742, 745-46 (1982).

[35]The Power Plant and Industrial Fuel Use Act of 1978. Pub. L. No. 95-617, 92 Stat. 3117 (codified in U.S.C. sections 15, 16, 26, 30, 42, and 43).

[36]QFs include certain cogenerators and small power producers. PURPA also added sections 210, 211, and 212 to the FPA, providing the Commission with authority to approve applications for interconnections and, in limited circumstances, wheeling. However, under section 211, as enacted in PURPA, the Commission could approve an application for wheeling only if it found, inter alia, that the order "would reasonably preserve existing competitive relationships." Because of this and other limitations in sections 211 and 212 as originally enacted, the provision was virtually ineffective. Only one section 211 order was ever issued pursuant to the original provision, and it was pursuant to a settlement. *See Public Service Company of Oklahoma*, 38 FERC ¶61,050 (1987). As discussed *infra*, section 211 was subsequently revised by the Energy Policy Act of 1992.

at a price not to exceed the utility's avoided costs and to sell backup power to QFs.[37]

PURPA specifically set forth limitations on who, and what, could qualify as QFs. In addition to technological and size criteria, PURPA set limits on who could own QFs.[38] Notwithstanding these limitations, QFs proliferated. In 1989, there were 576 QF facilities. By 1993, there were more than 1,200 such facilities.[39] For the same time period, installed QF capacity increased from 27,429 megawatts to 47,774 megawatts.[40] The rapid expansion and performance of the QF industry demonstrated that traditional, vertically integrated public utilities need not be the only sources of reliable power.

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[37]456 U.S. at p. 750. Congress recognized that encouragement was needed in part because utilities had been reluctant to purchase electric power from, and sell power to, nonutility generators. *Id.* at pp. 750-51.

[38]For example, PURPA provided that a cogeneration facility or small power production facility could not be owned by a person primarily engaged in the generation or sale of electric power (other than from cogeneration or small power production facilities). *See* 16 U.S.C.

[39]Energy Information Administration, *Electric Power Annual 1993* (December 1994) 124 (Table 77).

[40]*Id.* EIA data for 1989 through 1991 was for facilities of 5 megawatts or more and for 1992 and 1993 was for facilities of 1 megawatt or more. A comparison with Table 74 on page 121 for the years 1992 and 1993 reveals that this mixing of data bases is likely of minimal effect.

During this period, the profile of generation investment began to change, and a market for non-traditional power supply beyond the purchases required by PURPA began to emerge. QFs were limited to cogenerators and small power producers.[41]

However, other non-traditional power producers who could not meet the QF criteria began to build new capacity to compete in bulk power markets, without such PURPA benefits as the mandatory purchase requirements. These producers, known as independent power producers (IPPs), were predominantly single-asset generation companies that did not own any transmission or distribution facilities. While traditional utilities were generally **[31,643]** reluctant at that time to invest in new generating facilities under cost of service regulation, utilities increasingly became interested in participating in this new generation sector. They organized affiliated power producers (APPs), with assets not included in utility rate base, and sought to sell power in their own service territories and the territories of other utilities. At the same

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[41]Generally, the law has imposed an 80 MW cap on small power producers. A limited exception enacted in 1990 permitted small power facilities that could exceed 80 MW and still qualify as QFs under PURPA. This exception was limited to certain solar, wind, waste, and geothermal small power production facilities and only covered applications for certification of facilities as qualifying small power production facilities that were submitted no later than December 31, 1994 and for which construction commences no later than December 31, 1999. See Solar, Wind, Waste, and Geothermal Power Production Incentives Act of 1990, Pub. L. No. 101-575, 104 Stat. 2834 (1990), *amended*, Pub. L. No. 102-46, 105 Stat. 249 (1991).

time, power marketers arose. These entities -- owning no transmission or generation -- buy and sell power.[42]

There were two major impediments to the development of IPPs and APPs. First, the ownership restrictions of the Public Utility Holding Company Act (PUHCA)[43] severely inhibited these new entities from entering the generation business.[44] Second, these entities needed transmission service in order to compete in electricity markets.

While the Commission had no authority to remove PUHCA restrictions,[45] it encouraged the development of IPPs and APPs, as well as emerging power marketers, by authorizing market-based rates for their power sales on a case-by-case basis and by encouraging more widely available transmission access. From 1989 through 1993, facilities owned by IPPs and other non-traditional generators (other

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[42]The first power marketer in the electric industry was Citizens Energy Corporation. *See Citizens Energy Corporation*, 35 FERC ¶61,198 (1986). Power marketers take title to electric energy. Power brokers, on the other hand, do not take title and are limited to a matchmaking role.

[43]15 U.S.C. §79 *et seq.*

[44]As discussed *infra*, Congress eventually provided a means to avoid the PUHCA restrictions by creating exempt wholesale generators (EWGs) in the Energy Policy Act.

[45]The industry was successful to some extent in developing ownership structures that permitted such investment. *See, e.g., Commonwealth Atlantic Limited Partnership*, 51 FERC ¶61,368 at p. 62,240 and n.20 (1990).

than QFs) increased from 249 to 634 and their installed capacity increased from 9,216 megawatts to 13,004 megawatts.[46] Indeed, "[i]n 1992, for the first time, generating capacity added by independent producers exceeded capacity added by utilities."[47]

Market-based rates helped to develop competitive bulk power markets. A generating utility allowed to sell its power at market-based rates could move more quickly to take advantage of short-term or even long-term market opportunities than those laboring under traditional cost-of-service tariffs, which entail procedural delays in achieving tariff approvals and changes.

In approving these market-based rates, the Commission required, inter alia, that the seller and any of its affiliates lack market power or mitigate any market power that they may have possessed.[48] The major concern of the Commission was whether the seller or its affiliates could limit competition and thereby drive up prices. A key inquiry

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[46]Energy Information Administration, *Electric Power Annual 1993* (December 1994) 124 (Table 77).

[47]Black & Pierce, *supra* at p. 1349 n.25.

[48]*See, e.g., Ocean State Power*, 44 FERC ¶61,261 (1988); *Commonwealth Atlantic Limited Partnership*, 51 FERC ¶61,368 (1990); *Citizens Power & Light Company*, 48 FERC ¶61,210 (1989); *Orange and Rockland Utilities, Inc.*, 42 FERC ¶61,012 (1988); *Doswell Limited Partnership*, 50 FERC ¶61,251 (1990) (Doswell); and *Dartmouth Power Associates Limited Partnership*, 53 FERC ¶61,117 (1990).

became whether the seller or its affiliates owned or controlled transmission facilities in the relevant service area and therefore, by denying access or imposing discriminatory terms or conditions on transmission service, could foreclose other generators from competing.[49] As we have previously explained:

> The most likely route to market power in today's electric utility industry lies through ownership or control of transmission facilities. Usually, the source of market power is dominant or exclusive ownership of the facilities. However, market power also may be gained without ownership. Contracts can confer the same rights of control. Entities with contractual control over transmission facilities can withhold supply and extract monopoly prices just as effectively as those who control facilities through ownership.[50]

As entry into wholesale power generation markets increased, the ability of customers to gain access to the transmission services necessary to reach competing **[31,644]**

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[49] *See, e.g., Doswell,* 50 FERC at p. 61,757.

[50] *Citizens Power & Light Corporation*, 48 FERC ¶61,210 at p. 61,777 (1989) (emphasis in original); *see also Utah Power & Light Company, PacifiCorp and PC/UP&L Merging Corporation*, 45 FERC ¶61,095 at pp. 61,287-89 (1988), *order on reh'g*, 47 FERC ¶61,209, *order on reh'g*, 48 FERC ¶61,035 (1989), *remanded in part sub nom. Environmental Action, Inc. v. FERC*, 939 F.2d 1057 (D.C. Cir. 1991), *order on remand*, 57 FERC ¶61,363 (1991).

suppliers became increasingly important.[51] In addition, beginning in the late 1980s, in order to mitigate their market power to meet Commission conditions, public utilities seeking Commission approval of mergers or consolidations under section 203 of the FPA or Commission authorization for blanket approval of market-based rates for generation services under section 205 of the FPA, filed "open access" transmission tariffs of general applicability.[52] The

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[51]In earlier years, a few customers were able to obtain access as a result of litigation, beginning with the Supreme Court's decision in *Otter Tail Power Company v. United States*, 410 U.S. 366 (1973). Additionally, some customers gained access by virtue of Nuclear Regulatory Commission license conditions and voluntary preference power transmission arrangements associated with federal power marketing agencies. *See, e.g., Consumers Power Company*, 6 NRC 887, 1036-44 (1977) and *The Toledo Edison Company and Cleveland Electric Illuminating Company*, 10 NRC 265, 327-34 (1979). *See Florida Municipal Power Agency v. Florida Power and Light Company*, 839 F. Supp. 1563 (M.D. Fla. 1993). *See also* Electricity Transmission: Realities, Theory and Policy Alternatives, The Transmission Task Force Report to the Commission, October 1989, 197.

[52]*See, e.g., Public Service Company of Colorado*, 59 FERC ¶61,311 (1992), *reh'g denied*, 62 FERC ¶61,013 (1993); *Utah Power & Light Company, et al.*, Opinion No. 318, 45 FERC ¶61,095 (1988), *order on reh'g*, Opinion No. 318-A, 47 FERC ¶61,209 (1989), *order on reh'g*, Opinion No. 318-B, 48 FERC ¶61,035 (1989), *aff'd in relevant part sub nom. Environmental Action Inc. v. FERC*, 939 F.2d 1057 (D.C. Cir. 1991); *Northeast Utilities Service Company (Public Service Company of New Hampshire)*, Opinion No. 364-A, 58 FERC ¶61,070, *reh'g denied*, Opinion No. 364-B, 59 FERC ¶61,042, *order granting motion to*

Commission applied its market rate analysis to IOUs, as well as IPPs, APPs, and marketers, and allowed IOUs to sell at market-based rates only if they opened their transmission systems to competitors.[53] The Commission also approved proposed mergers on the condition that the merging companies remedy anticompetitive effects potentially caused by the merger by filing "open access" tariffs. These early "open access" tariffs required only that the companies provide point-to-point transmission services, which is a much narrower requirement than that being imposed in this Rule and did not require transmission owners to provide to others the same quality of service that they themselves enjoyed.

Following PURPA, the economic and technological changes in the transmission and generation sectors helped give impetus to the many new entrants in the generating markets who could sell electric energy profitably with smaller scale technology at a lower price than many utilities selling from their existing generation facilities at rates reflecting cost. However, it became increasingly clear that the potential consumer benefits that could be derived from these technological advances could be realized only if more efficient generating plants could obtain access to the regional transmission grids. Because many traditional vertically

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vacate and dismissing request for rehearing, 59 FERC ¶61,089 (1992), *affirmed in relevant part sub nom. Northeast Utilities Service Company v. FERC*, 993 F.2d 937 (1st Cir. 1993).

[53]*See, e.g., Public Service of Indiana, Inc.*, 51 FERC ¶61,367 (1990), *reh'g denied*, 52 FERC ¶61,260 (1990), *appeal dismissed sub nom. Northern Indiana Public Service Company v. FERC*, 954 F.2d 736 (D.C.Cir. 1992).

integrated utilities still did not provide open access to third parties and still favored their own generation if and when they provided transmission access to third parties, barriers continued to exist to cheaper, more efficient generation sources.

D. *The Energy Policy Act*

In response to the competitive developments following PURPA, and the fact that PUHCA and lack of transmission access remained major barriers to new generators, Congress enacted Title VII of the Energy Policy Act of 1992 (Energy Policy Act).[54] A goal of the Energy Policy Act was to promote greater competition in bulk power markets by encouraging new generation entrants, known as exempt wholesale generators (EWGs), and **[31,645]** by expanding the Commission's authority under sections 211 and 212 of the FPA to approve applications for transmission services.[55]

An EWG is defined as

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[54]Pub. L. No. 102-486, 106 Stat. 2776 (1992), codified at, among other places, 15 U.S.C. §79z-5a and 16 U.S.C. §796(22-25), 824j-l.

[55]*See El Paso Electric Company and Central and South West Services Inc.*, 68 FERC ¶61,181 at p. 61,914 (1994) (CSW); *see also* Paul Kemezis, FERC's Competitive Muscle: The Comparability Standard, Electrical World 45 (Jan. 1995) ("In EPAct, Congress made it clear that the electric-power industry was to move toward a fully competitive market system, but left most of the implementation to FERC.").

Any person determined by the Federal Energy Regulatory Commission to be engaged directly, or indirectly through one or more affiliates as defined in [PUHCA] section 2(a)(11)(B), and exclusively in the business of owning or operating, or both owning and operating, all or part of one or more eligible facilities and selling electric energy at wholesale.[56]

If the Commission, upon an application, determines that a person is an EWG, that person will be exempt from PUHCA.[57] This provision removed a significant impediment to the development of IPPs and APPs by allowing them to develop projects as EWGs free from the strictures of PUHCA or the QF PURPA limitations.

While sections 211 and 212, as enacted by PURPA, were intended to provide greater access to the transmission grid, the limitations placed on these sections made them unusable in virtually all circumstances.[58] However, as amended by the Energy Policy Act, these sections now give the Commission broader authority to order transmitting utilities to provide wholesale transmission services, upon application, to any electric utility, Federal power marketing agency, or any other person generating electric energy for sale for resale.

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[56]15 U.S.C. §79z-5a.

[57]15 U.S.C. §79z-5a(e).

[58]*See supra* note 36.

The Energy Policy Act also added section 213 to the FPA. Section 213(a) requires a transmitting utility that does not agree to provide wholesale transmission service in accordance with a good faith request to provide a written explanation of its proposed rates, terms, and conditions and its analysis of any physical or other constraints.[59] Section 213(b) required the Commission to enact a rule requiring transmitting utilities to submit annual information concerning potentially available transmission capacity and known constraints.[60]

E. *The Present Competitive Environment*

Following the Energy Policy Act, the Commission established rules: (1) for certain generators to obtain EWG

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[59]*See* Policy Statement Regarding Good Faith Requests for Transmission Services and Responses by Transmitting Utilities Under Sections 211(a) and 213(a) of the Federal Power Act, as Amended and Added by the Energy Policy Act of 1992, 58 FR 38964 (July 21, 1993), FERC Statutes and Regulations ¶30,975 (1993) (Policy Statement Regarding Good Faith Requests for Transmission Services).

[60]*See* New Reporting Requirements Implementing Section 213(b) of the Federal Power Act and Supporting Expanded Regulatory Responsibilities Under the Energy Policy Act of 1992, and Conforming and Other Changes to Form No. FERC-714, 58 FR 52420 (October 8, 1993), FERC *Statutes and Regulations* ¶30,980 (Order No. 558), *reh'g denied*, Order No. 558-A, 65 FERC ¶61,324 (1993), *regulations modified*, 59 FR 15333 (April 1, 1994), FERC *Statutes and Regulations* ¶30,993.

status and thus an exemption from PUHCA;[61] and (2) that required transmission information availability. The Commission also pursued a number of initiatives aimed at fostering the development of more competitive bulk power markets, including aggressive implementation of section 211, a new look at undue discrimination under the FPA, easing of market entry for sellers of generation from new facilities, and initiation of a number of industry-wide reforms. As stated by the Commission, in recognition of the Congressional goal in **[31,646]** the Energy Policy Act of creating competitive bulk power markets:

Our goal is to facilitate the development of competitively priced generation supply options, and to ensure that wholesale purchasers of electric energy can reach alternative power suppliers and vice versa.[62]

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[61] *See* Order No. 550, Filing Requirements and Ministerial Procedures for Persons Seeking Exempt Wholesale Generator Status, 58 FR 8897 (February 18, 1993), *FERC Statute and Regulations* ¶30,964, *order on reh'g*, Order No. 550-A, 58 FR 21250 (April 20, 1993), *FERC Statutes and Regulations* ¶30,969 (1993). As recognized by Congress and the Commission, availability of transmission information is critical in developing competitive markets. *See supra* notes 59 and 60. This opened the "black box" of information that previously was available only to transmission owners.

[62] *See* Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Notice of Proposed Rulemaking, 59 FR 35274 (July 11, 1994), FERC *Statutes and Regulations* ¶32,507 at p. 32,866 (Stranded Cost NOPR); *American Electric Power Service Corporation*, 67 FERC ¶61,168, *clarified*, 67 FERC ¶61,317 (1994).

1. Use of Sections 211 and 212 to Obtain Transmission Access

The Commission has aggressively implemented sections 211 and 212 of the FPA, as amended by the Energy Policy Act, in order to promote competitive markets.[63] When wheeling requests under sections 211 and 212 have been made, the Commission has required wheeling in almost all of the requests it has processed. To date, the Commission has issued orders (proposed or final) requiring wheeling in 12 of the 14 cases it has acted on.[64]

As a general matter, section 211 has permitted some inroads to be made by customers in obtaining transmission service from public utilities that historically have declined to provide access to their systems, or have offered service only on a discriminatory basis. Under section 211, the Commission has granted requests for the broader type of service that most utilities historically have refused to provide -- network service. Although transmission owners have provided limited amounts of unbundled point-to-point transmission service, third- party customers have not been able to obtain the flexibility of service that transmission owners enjoy.

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[63]16 U.S.C.A. §§824j-824k (West 1985 and Supp. 1994).

[64]*See, e.g.*, final orders issued in *City of Bedford*, 68 FERC ¶61,003 (1994), *reh'g denied*, 73 FERC ¶61,322 (1995); *Florida Municipal Power Agency v. Florida Power & Light Company*, 67 FERC ¶61,167 (1994), *order on reh'g*, 74 FERC ¶61,006 (1996); *Minnesota Municipal Power Agency*, 68 FERC ¶61,060 (1994); and *Tex-La Electric Cooperative of Texas*, 69 FERC ¶61,269 (1994); *see also* Appendix A.

In Florida Municipal, a section 211 case, the Commission ordered "network," rather than the narrower "point-to-point," service.[65] Network service permits the applicant to fully integrate load and resources on an instantaneous basis in a manner similar to the transmission owner's integration of its own load and resources. At the same time, the Commission made the generic finding that the availability of transmission service will enhance competition in the market for power supplies and lead to lower costs for consumers. The Commission explained that as long as the transmitting utility is fully and fairly compensated and there is no unreasonable impairment of reliability, transmission service is in the public interest.[66]

As discussed infra, based on the mounting competitive pressures in the industry and rapidly evolving markets, we

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[65]*See Florida Municipal Power Agency v. Florida Power & Light Company*, 65 FERC ¶61,125, *reh'g dismissed*, 65 FERC ¶61,372 (1993), *final order*, 67 FERC ¶61,167 (1994), *order on reh'g*, 74 FERC ¶61,006 (1996). The Commission has "characterized point-to-point service as involving designated points of entry into and exit from the transmitting utility's system, with a designated amount of transfer capability at each point." *El Paso Electric Company v. Southwestern Public Service Company*, 68 FERC ¶61,182 at p. 61,926 n.9 (1994) (*citing Entergy Services, Inc.*, 58 FERC ¶61,234 at p. 61,768 (1993), *reh'g dismissed*, 68 FERC ¶61,399 (1994)). Network service allows more flexibility by allowing a transmission customer to use the entire transmission network to provide generation service for specified resources and specified loads without having to pay multiple charges for each resource-load pairing.

[66]*Florida Municipal*, 67 FERC at p. 61,477.

have concluded that section 211 alone is not enough to eliminate undue discrimination. The comments received on the proposed rules, discussed in detail infra, confirm this conclusion. The significant time delays involved in filing an individual service request for bilateral service under section 211 place the customer at a severe disadvantage compared to the transmission owner and can result in discriminatory treatment in the use of the transmission system. It is an inadequate procedural substitute for readily available service under a filed non-discriminatory open access tariff. As the Commission noted in Hermiston Generating Company, **[31,647]** "[t]he ability to spend time and resources litigating the rates, terms and conditions of transmission access is not equivalent to an enforceable voluntary offer to provide comparable service under known rates, terms and conditions."[67]

2. Commission's Comparability Standard

In the Spring of 1994, the Commission began to address the problem of the disparity in transmission service that utilities provided to third parties in comparison to their own uses of the transmission system. In the seminal case in this area, American Electric Power Service Corporation (AEP), the company voluntarily proposed a tariff of general applicability that would offer firm, point-to-point transmission

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[67]69 FERC ¶61,035 at p. 61,165 (1994), *reh'g denied*, 72 FERC ¶61,071 (1995); *see also Southwest Regional Transmission Association*, 69 FERC ¶61,100 at p. 61,398 (1994), *order on compliance filing*, 73 FERC ¶61,147 (1995) *(SWRTA)*.

service for a minimum of one month.[68] The Commission accepted the proposed transmission tariff for filing and suspended its effectiveness for one day, subject to refund.[69] Rehearing requests challenged the Commission's summary approval of the restriction of service to point-to-point as being discriminatory and anticompetitive.[70] The rehearing requests argued that the tariff should be expanded to include network services such as those used by the transmission owner. On rehearing, the Commission announced a new standard for evaluating claims of undue discrimination.

The Commission found that a voluntarily offered, new open access transmission tariff that did not provide for services comparable to those that the transmission owner provided itself was unduly discriminatory and anticompetitive.[71] In reaching that conclusion, the

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[68]64 FERC 61,279 (1993), *reh'g granted*, 67 FERC ¶61,168, *clarified*, 67 FERC ¶61,317 (1994).

[69]The Commission explained that AEP could limit the service it was offering because it was "providing the service voluntarily under a tariff of general applicability." 64 FERC at p. 62,978.

[70]*AEP*, 67 FERC at p. 61,489.

[71]With respect to anticompetitive effects, the Commission explained that it has "adhered to the Supreme Court's determination that the Commission's 'important and broad regulatory power * * * carries with it the responsibility to consider, in appropriate circumstances, the anticompetitive effects of regulated aspects of interstate utility operations pursuant to sections 202 and 203, and under like directives contained in sections 205, 206 and 207.' *Gulf*

Commission broadened its undue discrimination analysis (which traditionally had focused on the rates, terms, and conditions faced by similarly situated third- party customers) to include a focus on the rates, terms, and conditions of a utility's own uses of the transmission system:

> (A)n open access tariff that is not unduly discriminatory or anticompetitive should offer third parties access on the same or comparable basis, and under the same or comparable terms and conditions, as the transmission provider's uses of its system.[72]

Refocusing the analysis was necessitated by the changing conditions in the electric utility industry, including the emergence of non-traditional suppliers and greater competition in bulk power markets. Because a transmission provider may use its system in different ways (e.g., to integrate load and resources when serving retail native load, to make off-system sales or purchases, or to serve wholesale requirements customers), the Commission set for hearing the factual issues associated with identifying those uses, as well as any potential impediments or consequences to providing comparable services to third parties.[73]

States Utilities Company v. FPC, 411 U.S. 747, 758-59 (1972)." *Id.* at p. 61,490 (footnote omitted). The Commission reaffirmed that it would examine how best to fulfill this responsibility, as well as its responsibility to prevent undue discrimination, in light of the changing conditions in the electric utility industry. *Id.*

[72] *Id.* at p. 61,490.

[73] *Id.* at pp. 61,490-91.

After AEP, the Commission applied this comparability standard to a proposed open access transmission tariff that was filed by Kansas City Power & Light Company (KCP&L) in support of a proposal to sell generation at market-based rates.[74] The Commission explained that, in light of AEP, the utility's proposed open access transmission tariff (which provided only **[31,648]** for point-to-point service) did not adequately mitigate its transmission market power so as to justify allowing the requested market-based rates. KCP&L could charge market-based rates for sales only if it modified its proposed transmission tariff to reflect the AEP comparability standard.

Since then, the Commission has required comparable service in a variety of contexts, and has set for hearing the factual issues associated with comparable service. For example, the Commission found that market power can be adequately mitigated only if a merged company offers transmission services in accordance with the AEP comparability standard.[75] The Commission further held that, even if a merger does not result in an increase in market power, the merger would not be consistent with the public interest under section 203 of the FPA unless the merged company offers comparable transmission services, as defined in AEP.[76] The Commission therefore announced a transmission comparability requirement for all new mergers:

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[74]*See Kansas City Power & Light Company*, 67 FERC ¶61,183 (1994), *reh'g pending*.

[75]*E.g.*, *CSW*, *supra*, 68 FERC at p. 61,914.

[76]*Id.*

Given the transition of the electric utility industry as a whole, we conclude that, absent other compelling public interest considerations, coordination in the public interest can best be secured only if merging utilities offer comparable transmission services.[77]

In Heartland Energy Services, Inc.,[78] the Commission applied its comparability standard to an affiliated electric power marketer seeking blanket authorization to sell electricity at market-based rates. The Commission explained that

For all future cases involving blanket approval of market-based rates an offer of comparable transmission services will be required before the Commission will be able to find that transmission market power has been adequately mitigated. In the context of an affiliated power marketer, this means that all of its affiliated utilities must have a comparable transmission tariff on file.[79]

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[77] *Id.* at p. 61,915 (footnote omitted).

[78] 68 FERC ¶61,223 (1994).

[79] *Id.* at p. 62,060. In *InterCoast Power Marketing Company*, 68 FERC ¶61,248, *clarified*, 68 FERC ¶61,324 (1994), the Commission rejected an affiliated marketer's proposal to sell at market rates without its affiliate utility offering comparable transmission services. The Commission stated that the only way to ensure that InterCoast does not have transmission market power is to require its affiliated public utility to offer comparable transmission services. *See also LG&E Power Marketing Inc.*, 68 FERC ¶61,247 at pp. 62,120-21 (1994). The Commission added

The Commission also denied a request by a company affiliated with a transmission-owning utility seeking permission to sell power at market-based rates to a particular customer. The denial was without prejudice to refiling such a request in a new section 205 proceeding, but only after the affiliated transmission-owning utility filed a comparable transmission service tariff.[80] The Commission added that it

> Will require comparability in any situation in which a seller seeking market-based rates is affiliated with an owner or controller of transmission facilities.[81]

The Commission has also stated that "it will henceforth apply the transmission comparability standard announced in the AEP case to all transmitting utility members of an RTG."[82]

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that this is consistent with encouraging competitive bulk power markets as envisioned by the Energy Policy Act of 1992. *Id.* at p. 62,132.

[80]*See Hermiston Generating Company*, 69 FERC ¶61,035 at p. 61,164 (1994), *reh'g pending*. The Commission subsequently accepted the rates on a cost basis. See Letter Order dated November 10, 1994.

[81]*Id.* at p. 61,165.

[82]*See SWRTA*, 69 FERC at p. 61,397; *see also PacifiCorp, the California Municipal Utilities Association, and the Independent Energy Producers (on behalf of Western Regional Transmission Association)*, 69 FERC ¶61,099, *order on reh'g*, 69 FERC ¶61,352 (1994), *order on compliance filing*, 71 FERC ¶61,158 (1995) (*WRTA*). An RTG is a regional transmission group. It is defined as

[31,649]

The Commission further declared that comparable services must be provided through "open access" tariffs rather than only on a contract-by-contract basis:

(T)ariffs are essential to the provision of comparable services. Tariffs set out the services that are available and the terms and conditions under which those services will be made available * * *. (In contrast), a negotiation process creates uncertainty- and imposes on customers delay and other transaction costs that the transmitting utility members of an RTG do not incur when using the transmission for their own benefit. Moreover, the ability to execute separate transmission agreements with different but similarly situated customers is the ability to unduly discriminate among them. A tariff ensures against such discrimination in the RTG.[83]

Thus, the Commission required the RTGs to amend their bylaws to commit all transmitting utility members to offer comparable transmission services to other RTG members pursuant to a transmission tariff or tariffs.

As discussed below, since the AEP comparability standard was announced, the Commission has set for hearing

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"a voluntary organization of transmission owners, transmission users, and other entities interested in coordinating transmission planning (and expansion), operation and use on a regional (and inter- regional." Policy Statement Regarding Regional Transmission Groups, 58 FR 41626 (August 5, 1993), *FERC Statutes and Regulations* ¶30,976, at p. 30,870 n.4 (RTG Policy Statement).

[83]*SWRTA*, 69 FERC at p. 61,398.

44 open access tariffs to determine what constitutes comparable service. This number includes tariffs filed subsequent to the Open Access NOPR. All tariffs have now been made subject to the outcome of the Final Rule.

3. Lack of Market Power in New Generation

In 1994 in the KCP&L case, discussed in the prior section, the Commission continued to recognize that transmission remains a natural monopoly. However, it found that, in light of the industry and statutory changes that now allow ease of market entry, no wholesale seller of generation has market power in generation from new facilities.[84] In particular, the Commission explained that it had previously noted in Entergy Services, Inc. that

There was significant evidence that non-traditional power project developers, including qualifying facilities and independent power projects, are becoming viable competitors in long-run markets.[85]

The Commission further explained that since Entergy, Congress had enacted the Energy Policy Act, which had lowered barriers to the entry of new suppliers by creating a new class of power suppliers -- EWGs -- that are exempt from

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[84] *KCP&L*, 67 FERC ¶61,183 (1994).

[85] *Id.* at p. 61,557 (citing *Entergy Services, Inc.*, 58 FERC ¶61,234 at p. 61,756 and nn.63 and 65 (*Entergy*)).

the provisions of PUHCA.[86] The Commission concluded that, in considering market-based rate proposals for generation sales, it need only focus on market power in transmission, generation market power in short-run markets, and other barriers to entry.[87]

4. Further Commission Action Addressing a More Competitive Electric Industry

To address the fact that the electric industry is becoming more competitive, and to remove barriers that might inhibit a more competitive industry, the Commission has initiated a number of proceedings: (1) Stranded Cost NOPR,[88] (2) Transmission Pricing Policy Statement,[89] (3) Pooling Notice of Inquiry,[90] (4) Regional Transmission Group

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[86]*Id.* The Commission added that "after examining generation dominance in many different cases over the years, we have yet to find an instance of generation dominance in long-run bulk power markets." *Id.*

[87]*Id.*

[88]*FERC Statutes and Regulations* ¶32,507 (1994).

[89]Inquiry Concerning the Commission's Pricing Policy for Transmission Services Provided by Public Utilities Under the Federal Power Act, 59 FR 55031 (November 3, 1994), *FERC Statutes and Regulations* ¶31,005 (Transmission Pricing Policy Statement).

[90]Inquiry Concerning Alternative Power Pooling Institutions Under the Federal Power Act, 59 FR 54851 (October 26, 1994), *FERC Statutes and Regulations* ¶35,529 (1995) (Pooling Notice of

(RTG) Policy Statement,[91] and (5) Notice of Inquiry on Merger Policy.[92]

In the Stranded Cost NOPR the Commission recognized that the trend toward greater transmission access and the transition **[31,650]** to a fully competitive bulk power market could cause some utilities to incur stranded costs as wholesale requirements customers (or retail customers) use their supplier's transmission to purchase power elsewhere. As the Commission noted, a utility may have built facilities or entered into long-term fuel or purchased power supply contracts with the reasonable expectation that its customers would renew their contracts and would pay their share of long-term investments and other incurred costs. If the customer obtains another power supplier, the utility may have stranded costs. If the utility cannot locate an alternative buyer or somehow mitigate the stranded costs, the Commission explained that "the costs must be recovered from either the departing customer or the remaining customers or borne by the utility's shareholders."[93] Accordingly, the Commission proposed to establish provisions concerning the recovery of wholesale and retail stranded costs by public utilities and transmitting utilities.

Inquiry).

[91]*FERC Statutes and Regulations* ¶30,976 (RTG Policy Statement).

[92]*FERC Statutes and Regulations* ¶35,531 (1996).

[93]*FERC Statutes and Regulations* ¶32,507 at p. 32,864.

In the Transmission Pricing Policy Statement, the Commission announced a new policy providing greater flexibility in the pricing of transmission services provided by public utilities and transmitting utilities. The Commission traditionally had allowed only postage-stamp, contract-path pricing.[94] Under the new policy, we will permit a variety of proposals, including distance sensitive and flow-based pricing, which may be more suitable for competitive wholesale power markets.[95] The Commission explained that this "(g)reater pricing flexibility is appropriate in light of the significant competitive changes occurring in wholesale generation markets, and in light of our expanded wheeling authority

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[94]Most transmission contracts set a single price for energy flow over a utility's transmission system. This single- price policy is called "postage stamp" pricing because the rate does not depend on how far the power moves within a company's transmission system. If power flows through several companies, traditional industry practice is to specify that power flows along a "contract path" consisting of the transmission-owning utilities between the ultimate receipt and delivery points. *See Indiana Michigan Power Company*, 64 FERC ¶61,184 at p. 62,545 (1993).

[95]Unlike with postage stamp pricing, with distance-sensitive pricing the cost of moving power through a company depends on how far the power moves within the company. In contrast to contract path pricing, flow-based pricing establishes a price based on the costs of the various parallel paths actually used when the power flows. Because flow-based pricing can account for all parallel paths used by the transaction, all transmission owners with facilities on any of the parallel paths could be compensated for the transaction.

under the Energy Policy Act of 1992."[96] However, the Commission explained that any new transmission pricing proposal must meet the Commission's AEP comparability standard. The Commission further explained that comparability of service applies to price as well as to terms and conditions.[97]

The Commission issued the Pooling Notice of Inquiry to receive comments on traditional power pools and on alternative power pooling institutions that are being explored in today's more competitive environment. The Commission expressed concern that

(G)iven the ongoing changes in the competitive environment of the electric utility industry -- in particular, the potential for substantially increased access to transmission -- we must consider whether we are appropriately balancing our dual objectives of promoting coordination and competition.[98]

Accordingly, the Commission explained that it wished to look at alternative power pooling institutions and to re-examine the role of more traditional power pools in today's environment of increased competition. In particular the Commission expressed its intent to ensure that its policies "are

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[96]*FERC Statutes and Regulations* ¶31,005 at p. 31,136.

[97]*Id.* at p. 31,142.

[98]*FERC Statutes and Regulations* ¶35,529 at p. 35,715.

consistent with the development of a competitive bulk power market."[99]

In the RTG Policy Statement, the Commission announced a policy encouraging the development of RTGs. The Commission explained that a primary purpose of RTGs is to facilitate transmission access for potential users and voluntarily resolve **[31,651]** disputes over such service. The Commission has approved the formation of three RTGs.[100] One of the conditions is that each RTG member must offer comparable transmission services by tariff to other RTG members.

In the merger NOI, the Commission indicated that it will review whether its criteria and policy for evaluating mergers need to be modified in light of the changing circumstances occurring in the electric industry. In addition to the Commission's actions, a number of states have initiated proceedings concerning retail wheeling or proposed legislation for retail wheeling, that is, for ultimate consumers to choose their supplier of power, or other restructuring proposals.[101]

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[99]*Id.* at p. 35,714. As explained below, the Commission held technical conferences on issues surrounding power pools and competition.

[100]*See WRTA* and *SWRTA*, *supra*, and *Northwest Regional Transmission Association*, 71 FERC ¶61,397 (1995).

[101]At least 12 states have retail wheeling proposals, legislation, or pilot programs underway -- Alabama, California, Connecticut, Illinois, Massachusetts, Michigan, New Hampshire, New York, Ohio, Rhode Island, Vermont, and Wisconsin. At least

5. Events Since Issuance of Open Access NOPR

Since issuance of the Open Access NOPR, public utilities have filed, in some form or another, 47 open access tariffs. In acting on those filings, the Commission has made all of the non- rate terms and conditions of those proposed tariffs subject to the outcome of this Final Rule.[102]

Over the last year, the Commission also has received and analyzed more than 20,000 pages of comments that were received from over 400 commenters, as well as additional information provided by industry participants at a number of Commission-initiated technical conferences.[103] Those technical

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14 other states are investigating retail wheeling. Currently, according to a report of the NARUC-affiliated National Council on competition and the Electric Industry, 41 States are actively involved in investigating whether and how to restructure their respective electric power markets. Of this total, 29 State regulatory authorities * * * have initiated investigations. In addition, five State legislatures are involved in similar investigations, while seven other States have joint regulatory/legislative proceedings underway.

Testimony of the Honorable Cheryl L. Parrino, Chair of the Wisconsin Public Service Commission, on behalf of the National Association of Regulatory Utility Commissioners, before the United States Senate Committee on Energy and Natural Resources (March 6, 1996).

[102] *See American Electric Power Service Corporation,* et al., 72 FERC ¶61,287 at p. 61,238 (1995).

[103] Attached to this Final Rule as Appendix B is a list of commenters and the abbreviations used to designate them, including

conferences addressed several issues -- ancillary services, pro forma tariffs, power pools, and ISOs -- and provided significant input to the Commission's formulation of this Final Rule.

F. *Need for Reform*

The many changes discussed above have converged to create a situation in which new generating capacity can be built and operated at prices substantially lower than many utilities' embedded costs of generation. As discussed above, new generation facilities can produce power on the grid at a cost of less than 3 cents per kWh to 5 cents per kWh, yet the costs for large plants constructed and installed over the last decade were typically in the range of 4 to 7 cents per kWh for coal plants and 9 to 15 cents for nuclear plants.

Non-traditional generators are taking advantage of this opportunity to compete. Indeed, the non-traditional generators' share of total U.S. electricity generation increased from 4 percent in 1985 to 10 percent in 1993.[104] Much of this increased share of generation is the result of competitive bidding for new generation resources that has occurred in 37 states. Since 1984, almost 4,000 projects, representing over 400,000 MW, have been offered in response to requests. Over 350 projects have been selected to supply 20,000 MW, and,

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those commenters that filed late.

[104]Energy Information Administration, *Performance Issues for a Changing Electric Power Industry* (January 1995) 10 and (Figure 5).

of these, 126 are now online producing almost 7,800 MW of power.[105]

In addition, the cost of utility-generated electricity differs widely across the major regions of the United States. Average utility rates range from 3 to 5 cents in the Northwest to 9 to 11 cents in California. **[31,652]** Electricity consumers are demanding access to lower cost supplies available in other regions of the United States, and access to the newer, lower cost generation resources. Therefore, it is important that the non-traditional generators of cheaper power be able to gain access to the transmission grid on a non-discriminatory open access basis.

The Commission's goal is to ensure that customers have the benefits of competitively priced generation. However, we must do so without abandoning our traditional obligation to ensure that utilities have a fair opportunity to recover prudently incurred costs and that they maintain power supply reliability. As well, the benefits of competition should not come at the expense of other customers. The Commission believes that requiring utilities to provide non-discriminatory open access transmission tariffs, while simultaneously resolving the extremely difficult issue of recovery of transition costs (discussed infra), is the key to reconciling these competing demands.

Non-discriminatory open access to transmission services is critical to the full development of competitive

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[105]Current Competition, November 1994, Vol. 5, No. 8, at p. 8.

wholesale generation markets and the lower consumer prices achievable through such competition.[106] Transmitting utilities own the transportation system over which bulk power competition occurs and transmission service continues to be a natural monopoly. Denials of access (whether they are blatant or subtle), and the potential for future denials of access, require the Commission to revisit and reform its regulation of transmission in interstate commerce. As discussed in detail in Section IV.B., such action is required by the FPA's mandate that the Commission remedy undue discrimination.

Since the time the NOPR issued, the Commission staff has completed an FEIS that provides a quantitative estimate of some of the cost savings expected from this Rule: approximately $3.8 to $5.4 billion per year. Other non-quantifiable benefits are also expected from this Rule and include: (1) better use of existing assets and institutions; (2) new market mechanisms; (3) technical innovation; and (4) less rate distortion. These potential benefits to the Nation's electricity consumers and the economy as a whole confirm the need to take generic action to remove barriers to competition. In what follows, we set out the changes necessary to remedy undue discrimination and to ensure a fair transition to a more competitive regulatory regime.

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[106]As discussed above, a significant number of public utilities still do not have any form of an "open access" tariff on file with the Commission and no public utility has on file a non-discriminatory open access tariff as defined by this Rule.

IV. Discussion

A. *Scope of the Rule*

1. Introduction

The Commission has determined that non-discriminatory open access transmission services (including access to transmission information) and stranded cost recovery are the most critical components of a successful transition to competitive wholesale electricity markets. These issues are the focal point of this Rule, the accompanying rule on open access same-time information systems, and the accompanying proposed rule on capacity reservation tariffs.

In undertaking these initiatives, however, we are mindful that they are part of a broader picture of evolving issues affecting the electric industry and that other Commission policies will play an important role in ensuring the full development of competitive markets. Among the many issues that are important to competitive bulk power markets are: independent system operators (ISOs); regional transmission groups; generation market power; utility merger policy; and the development of innovative transmission pricing alternatives, such as flow-based, distance-sensitive transmission pricing methodologies that reflect incremental costs. In particular, we believe that ISOs have great potential to assist us and the industry to help provide regional efficiencies, to facilitate economically efficient pricing, and, especially in the context of power pools, to remedy undue discrimination and mitigate market power. Although we discuss some of these issues in this Rule, we will further

develop our policies in other proceedings as well to accommodate and encourage more efficient market structures.

[31,653]

We now address the comments received on the scope of the proposed rulemaking.

2. Functional Unbundling

In the NOPR, the Commission preliminarily found that functional unbundling of wholesale generation and transmission services is necessary to implement non-discriminatory open access transmission.[107] At the same time, the Commission explained that the proposed rule would accommodate, but not require, corporate unbundling (which could include selling generation or transmission assets to a non-affiliate (divestiture) or the less aggressive step of establishing separate corporate affiliates to manage a utility's transmission and generation assets). However, we invited comments on functional unbundling and asked whether it is a strong enough measure to ensure non-discriminatory open access transmission without some form of corporate restructuring.

Comments

Commenters take both sides on whether functional unbundling is sufficient to assure non-discriminatory open access transmission or whether a stronger measure, such as

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[107] *FERC Statutes and Regulations* ¶32,514, at p. 33,080.

corporate unbundling, is needed. Supporting functional unbundling

Various commenters, including utilities and state commissions, generally support functional unbundling as sufficient to assure non-discriminatory open access transmission and oppose requiring corporate unbundling or divestiture.[108] Several commenters state that functional unbundling will remedy discrimination without creating the inefficiencies and additional costs that corporate restructuring would create.[109]

A number of other commenters argue that the Commission has no authority under the FPA to require divestiture of transmission assets.[110] Several of these commenters assert that, even if the Commission has the authority, the electric industry, unlike the natural gas industry, is not ready for mandated corporate unbundling because electric utilities still serve a high percentage of retail customers and own large amounts of the generating capacity.

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[108] *E.g.*, Ohio Edison, UtiliCorp, Pennsylvania P&L, Atlantic City, Montana Power, IL Com, Seattle, OK Com, TX Industrials, MidAmerican, Southwestern, Southern, DOD, Public Service Co of CO, SC Public Service Authority, Florida Power Corp, DOE, WP&L, Com Ed, SBA, Consumers Power, CA Com, UT Com, Houston L&P, KCPL, EEI.

[109] *E.g.*, Florida Power Corp, El Paso, PSNM, and SC Public Service Authority.

[110] *E.g.*, Southwestern, PECO, El Paso, Florida Power Corp, NSP, Public Service E&G, MidAmerican.

They assert that transmission system operation requires the operator to have control over much of the generating capacity.

Various other commenters also support functional unbundling, but believe that safeguards are needed to make it work.[111] Power Marketing Association, for example, suggests a number of safeguards: adoption of cost allocation mechanisms to ensure that utilities do not shift costs from generation to transmission; random audits of utility books; a requirement that each utility file a code of conduct that provides for maximum separation of generation and transmission functions; and active oversight and complaint procedures with strong penalties for abuse. OK Com and GA Com believe that functional unbundling along with the safeguard of the Commission's complaint process will provide sufficient incentive for non-discriminatory open access transmission.

Supporting Corporate Unbundling

A number of commenters see weaknesses in functional unbundling and argue that some form of corporate unbundling is necessary to assure non-discriminatory open access transmission.[112] American Forest & Paper says that there is

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[111]*E.g.*, NRECA, IN Com, Power Marketing Association, TDU Systems, NorAm, Turlock, Texaco, Utility Shareholders, NSP, El Paso, Utility Investors Analysts, PECO, Florida Power Corp, UT Com, Sierra, Carolina P&L, SoCal Gas, OK Com, FL Com, Southern.

[112]*E.g.*, American Forest & Power, American National Power, ND Com, IL Com, UAMPS, NIEP, APPA, Public Power

affiliate abuse in the gas industry and argues that **[31,654]** the electric industry presents even more serious potential for abuse because it is still dominated by vertically integrated utilities.[113] UAMPS asserts that functional unbundling is insufficient because the utility will still favor itself on issues related to transmission planning, capital investment, and operation and maintenance and replacement costs.

NIEP argues that divestiture of generation assets from transmission and distribution is the preferred mechanism for mitigating market power. It further suggests that if corporate divestiture is not feasible the Commission should

Seek to achieve "virtual divestiture" by requiring that the utility generation function be separated from transmission and distribution functions in a separate corporate affiliate, or business unit, and that affiliate transaction rules be established to guard against possible abuses.[114]

It maintains that the Commission has broad authority to protect against undue discrimination and anticompetitive

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Council, Municipal Energy Agency Nebraska, Missouri Basin MPA, Texaco, Direct Services Industries, Calpine, CCEM, Wisconsin Coalition, VT DPS.

[113]*See also* American National Power, ND Com, Calpine.

[114]NIEP Initial Comments at p. 4.

behavior and can order divestiture if such action is required to remedy such behavior.[115]

FTC and DOJ argue that operational unbundling, an example of which is the formation of an independent system operator (ISO), likely would be more effective than functional unbundling and less costly than industry-wide divestiture.[116] FTC describes operational unbundling as "structural institutional arrangements, short of divestiture, that would separate operation of the transmission grid and access to it from economic interests in generation." It gives as an example the California proposal under which utilities would continue to own transmission lines, but an independent system operator would have operational control. DOJ also suggests "a separate authority" to manage the grid and access to the grid, joint ventures, and voluntary pooling arrangements. These commenters argue that operational unbundling would be easier to enforce than functional unbundling.

DOE states that separation of the control of transmission from vertically-integrated companies does not necessarily require a poolco or any particular market mechanism. It suggests the possibility of an ISO that is functionally separate from any buyer or seller of generation, but would not perform all the functions of a poolco.

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[115]*See also* Municipal Energy Agency Nebraska, Direct Services Industries.

[116]Others oppose operational unbundling. *See, e.g.*, Carolina P&L, Salt River.

United Illuminating supports "operational unbundling" that would either (1) eliminate vertical integration and divestiture of transmission assets, leading to the formation of a regional transmission company, or (2) develop a regional contractual approach to transmission services that eliminates the transmission owner's market power and fairly allocates support of the transmission facilities between native load and third-party users of the system. Commission Conclusion

We conclude that functional unbundling of wholesale services is necessary to implement non-discriminatory open access transmission and that corporate unbundling should not now be required. As we explained in the NOPR, functional unbundling means three things:

(1) A public utility must take transmission services (including ancillary services) for all of its new wholesale sales and purchases of energy under the same tariff of general applicability as do others;

(2) A public utility must state separate rates for wholesale generation, transmission, and ancillary services;

(3) A public utility must rely on the same electronic information network that its transmission customers rely on to obtain information about its transmission system when buying or selling power.

We believe that these requirements are necessary to ensure that public utilities provide non-discriminatory

service.[117] These requirements also will give public **[31,655]** utilities an incentive to file fair and efficient rates, terms, and conditions, since they will be subject to those same rates, terms, and conditions.

However, we recognize that additional safeguards are necessary to protect against market power abuses. Functional unbundling will work only if a strong code of conduct (including a requirement to separate employees involved in transmission functions from those involved in wholesale power merchant functions) is in place. In the RINs NOPR, the Commission proposed a code of conduct that would apply to all public utility transmission providers. As the Commission explained,

[T]his code of conduct would require, among other matters, a separation of the utilities' transmission system operations and wholesale marketing functions, and would define permissible and impermissible contacts between employees that conduct wholesale generation marketing functions and employees that handle transmission system operations and reliability in the system control center or at other facilities or locations.[118]

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[117]When and how functional unbundling is to be achieved for requirements transactions and for various types of coordination arrangements, including power pools, is discussed at Sections IV.A.5 and IV.F. Functional unbundling of ancillary services is discussed in Section IV.D.

[118]Real-Time Information Networks and Standards of Conduct, Notice of Proposed Rulemaking, 60 FR 66182 (December 21, 1995), *FERC Statutes and Regulations* ¶32,516 at p. 33,170

Adoption of this code of conduct, discussed in detail in the accompanying final rule on OASIS,[119] is needed to ensure that the transmission owner's wholesale marketing personnel and the transmission customer's marketing personnel have comparable access to information about the transmission system.

As noted by OK Com and GA Com, a further safeguard -- section 206 -- is available if a public utility seeks to circumvent the functional unbundling requirements. Under section 206, any person is free to file a complaint with the Commission detailing any alleged misbehavior on the part of the public utility or its affiliates concerning matters subject to our jurisdiction under the FPA. Similarly, the Commission may, on its own motion, initiate a proceeding to investigate the practices of the public utility and its affiliates.

We believe that functional unbundling, coupled with these safeguards, is a reasonable and workable means of assuring that non-discriminatory open access transmission occurs. In the absence of evidence that functional unbundling will not work, we are not prepared to adopt a more intrusive and potentially more costly mechanism -- corporate unbundling -- at this time.

(1995).

[119]The final rule on information systems no longer uses the terminology RINs. The new terminology used is OASIS -- Open Access Same-time Information System -- which we will use in this Final Rule.

Several commenters discuss the need to encourage or even to require ISOs in the context of functional unbundling. We believe that ISOs have the potential to provide significant benefits (e.g., to help provide regional efficiencies, to facilitate economically efficient pricing, and, especially in the context of power pools, to remedy undue discrimination and mitigate market power) and will further our goal of achieving a workably competitive market. As we learned at our technical conference on power pools, many utilities are examining ISOs and corporate unbundling in various shapes and forms, particularly in the context of power pools. We discuss ISOs extensively in our section on power pools where we believe they will have an important role to play. However, in the context of individual utility transactions, we believe that the less intrusive functional unbundling approach outlined above is all that we must require at this time. Nevertheless, we see many benefits in ISOs, and encourage utilities to consider ISOs as a tool to meet the demands of the competitive marketplace.

As a further precaution against discriminatory behavior, we will continue to monitor electricity markets to ensure that functional unbundling adequately protects transmission customers. At the same time, we will analyze all alternative proposals, including formation of ISOs, and, if it becomes apparent that functional unbundling is inadequate or unworkable in assuring non-discriminatory open access transmission, we will reevaluate our position and decide whether other mechanisms, such as ISOs, should be required.

Finally, while we are not now requiring any form of corporate unbundling, we again encourage utilities to explore whether corporate unbundling or other restructuring **[31,656]**

mechanisms may be appropriate in particular circumstances. Thus, we intend to accommodate other mechanisms that public utilities may submit, including voluntary corporate restructurings (e.g., ISOs, separate corporate divisions, divestiture, poolcos), to ensure that open access transmission occurs on a non-discriminatory basis. We also will continue to monitor -- and stand ready to work with parties engaging in -- innovative restructuring proposals occurring around the country.

3. Market-Based Rates

a. Market-Based Rates for New Generation

In the NOPR, the Commission proposed to codify its determination in Kansas City Power & Light Company[120] that the generation dominance standard for market-based sales from new capacity be dropped.[121] The proposed new section 35.27 would provide:

Notwithstanding any other requirements, any public utility seeking authorization to engage in sales for resale of electric energy at market-based rates shall not be required to demonstrate any lack of market power in generation with respect to sales from capacity first placed in service on or after June 10, 1996.[122]

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[120]67 FERC ¶61,183 at p. 61,557 (1994), *reh'g pending* (KCP&L).

[121]*FERC Statutes and Regulations* ¶32,514 at p. 33,050.

[122]*Id.* at p. 33,154.

However, this proposal would not affect the Commission's continuing authority to look at whether an applicant and its affiliates could erect other barriers to entry and whether there may be affiliate abuse or reciprocal dealing.[123]

Comments

A number of commenters support the Commission's determination in KCP&L[124] and several of them explicitly support the Commission's proposed codification.[125] EEI asserts that more than 50 percent of new generation is from non-utility sources and that recent competitive solicitations for new capacity have been greatly over-subscribed. Entergy argues that there is no evidence in any proceeding thus far of a market power problem in long-run markets.

Other commenters, however, oppose codifying KCP&L.[126] They believe that market power in long-run markets exists for both new and old generation due to, for example, constraints on interface capabilities and unduly long notice periods for replacement of purchases. They argue that

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[123]67 FERC at p. 61,557.

[124]*E.g.*, Entergy, EEI, Atlantic City, Duke Centerior, Houston L&P, Montana-Dakota Utilities, Canadian Petroleum Producers, DOE, Florida Power Corp, PSNM.

[125]*E.g.*, EEI, Centerior, Houston L&P, NYSEG.

[126]*E.g.*, TDU Systems, ELCON, NRECA, Environmental Action, NIEP, APPA, Power Marketing Association, EGA.

there is not enough of a distinction between new and old generation to treat them differently. TDU Systems also notes that the Commission in KCP&L did not take into account the differences between firm and non- firm bulk power. NIEP and ELCON conclude that the Commission erroneously found in KCP&L that no wholesale seller of generation has market power in generation from new facilities. NIEP asserts that in each service area there is usually only one wholesale buyer -- the utility -- who also is virtually always a wholesale seller of generation. Under these circumstances, NIEP argues that there cannot be arm's-length bargaining. Environmental Action complains that the Commission's proposal to codify KCP&L ignores significant factors that impede entry to generation markets, such as utility resistance to purchased power, state government-created barriers to non-utility generation, pancaking of rates under the contract path approach, sunk investment, and scale economies.

Commission Conclusion

In reviewing applications to sell at market-based rates, whether from new (unbuilt) capacity or existing capacity, we require that the seller (and each of its affiliates) must not have, or must have mitigated, market power in generation and transmission and not control other barriers to entry. In order to demonstrate the requisite absence or mitigation of transmission market power, a transmission-owning public utility seeking to sell at market-based rates must have on file **[31,657]** with the Commission an open access transmission tariff for the provision of comparable service. In addition, the

Commission considers whether there is evidence of affiliate abuse or reciprocal dealing.[127]

In KCP&L, we stated that "in light of industry and statutory changes which allow ease of market entry, we therefore will no longer require rate applicants to submit evidence of generation dominance in long-run bulk power markets."[128] We further explained that we had examined "generation dominance in many different cases over the years" and had "yet to find an instance of generation dominance in long-run bulk power markets."[129] Commenters have criticized our findings in KCP&L, but no commenter has provided any evidence of generation dominance in long-run bulk power markets. Moreover, we have seen no such evidence in any of the market-based rate cases we have considered since KCP&L. Based on the comments received, we will codify the Commission's determination in KCP&L that the generation dominance standard for market-based sales from new capacity should be dropped. Because the Commission's findings in KCP&L applied to long-run markets, we will revise proposed §35.27 to apply to sales

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[127]*See, e.g., MidAmerican Energy Company*, 74 FERC ¶61,211 (1996).

[128]*KCP&L*, 67 FERC at p. 61,557. *See also* discussion in proposed rule, *FERC Statutes and Regulations* at pp. 33,067-68.

[129]*Id.*

from capacity for which construction has commenced on or after the effective date of this Rule.[130]

The Commission wishes to clarify that dropping the generation dominance standard for new capacity does not affect the demonstration that an applicant must make in order to qualify for market-based rates for sales from its existing generating capacity. In other words, the fact that an applicant need not demonstrate its lack of generation dominance with respect to new capacity cannot be used to "bootstrap" the authorization of market-based rates for its existing capacity. Moreover, our evaluation of market-based rates for existing capacity will include consideration of new capacity.

In addition, the fact that we are codifying KCP&L does not mean that we will ignore specific evidence presented by an intervenor that a seller requesting market-based rates for sales from new generation nevertheless possesses generation dominance. For example, if the evidence indicated that the new generator, due to its proximity to an existing transmission constraint, could significantly influence the ability to move power across the constraint, we would consider such evidence in determining whether to grant the

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[130]The NOPR's proposed language that a public utility would not have to demonstrate a lack of market power in generation for sales from capacity first placed in service on or after the date 30 days after the final rule is published in the *Federal Register* does not properly reflect the finding in *KCP&L*. Because *KCP&L* addressed new or unbuilt generation, the proposed language is being revised as indicated above and as set forth in the regulatory text included with this Final Rule.

applicant's request.[131] If such evidence is presented, the Commission will evaluate whether the evidence disproves the premise that the seller lacks generation dominance with respect to its new capacity.

If the applicant has existing generation, the sales from which are authorized to be made on a market basis, the Commission would consider whether the new generation (when added to the existing generation with market-based authority) results in the applicant having generation dominance. On the other hand, if the applicant has existing generation, the sales from which are subject to cost-of-service regulation, the Commission would not include this generation in its analysis of the applicant's request for market-based rates for its new generation. The question of whether or not the applicant lacks generation dominance with respect to its existing capacity is relevant only if, and when, the seller applies to the Commission for authority to make wholesale sales for its existing capacity at market-based rates.

If evidence regarding an applicant's generation dominance with respect to its new capacity is submitted, the applicant would be required to provide a satisfactory rebuttal.

[31,658]

b. Market-Based Rates for Existing Generation

In the NOPR, the Commission explained that increased competition resulting from open access transmission may

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[131] *Cf. Wisconsin Electric Power Company, et al.*, 74 FERC ¶61,069 at p. 61,193 (1996).

reduce or even eliminate generation-related market power in the short-run market (sales from existing capacity).[132] Because market power has been the primary concern of the Commission in analyzing requests for market-based rates for such sales, we sought comments on the effect of industry-wide non-discriminatory open access on our criteria for authorizing power sales at market- based rates. The Commission also sought comments on whether the generation dominance standard should be dropped for market-based sales from existing capacity.

Comments

Many commenters support, but many also oppose, market-based rates for existing generation without a case-specific analysis of generation dominance.

Supporting Market-Based Rates for Existing Generation.

Many commenters (primarily IOUs and a number of state commissions) assert that existing generators will not possess market power after implementation of non-discriminatory open access transmission and that market-based rates should be permitted generically for sales from existing generation.[133]

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[132]*FERC Statutes and Regulations* ¶32,514, at pp. 33,093-94.

[133]*E.g.*, EEI, CINergy, Central Illinois Public Service, Citizens Utilities, Com Ed, Ohio Edison, Allegheny, Southern, Portland, NRRI, Pennsylvania P&L, PECO, Dayton P&L, Utilities For Improved Transition, Centerior, Houston L&P, Duke, ConEd,

EEI asserts that market power concerns generally would be transitory, limited to the time needed to build new facilities. Thus, it recommends that all markets be declared competitive by a date certain and that market-based rates then be allowed, with customers permitted to file complaints. Florida Power Corp believes that existing procedures under sections 205 and 206 will adequately protect consumers. Other commenters also urge the Commission to eliminate its generation dominance standard, but assert that the Commission should allow a showing of market dominance in a complaint or show cause proceeding.[134] CT DPUC notes that the Commission should be able to rely on rules of conduct, market mechanisms, and monitoring to curb any market power that may exist.

Utilities For Improved Transition argues that if utilities cannot get market-based rates, the new players in the market will have an unfair advantage, since they do not have to carry the traditional utilities' burden of older, less efficient plants.

Entergy proposes a screening test that would permit the Commission to "deregulate" wholesale sales to certain short-run markets. CINergy recommends that after industry-wide open access tariffs become effective, the Commission adopt a rebuttable presumption that all markets are workably

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IPALCO, Salt River, PJM, NU, NYSEG, Oklahoma G&E, PA Com, OK Com, CT DPUC, CA Com, MT Com.

[134] *E.g.*, Consumers Power, Portland, Dayton P&L, CSW.

competitive; that presumption could be rebutted in a section 206 proceeding.[135]

UtiliCorp, while it believes that market power will probably be fully mitigated by open access, also argues that the Commission should examine generation dominance on a region-by-region basis.[136] Montana-Dakota Utilities argues that the Commission should allow all suppliers in a power pool or RTG to have market-based rates after a Commission finding that there is sufficient generation competition within the region.

Duke states that it would be highly inconsistent for the Commission to require open access, but not allow utilities to compete in the market. It further states that the relevant market should be determined using standard antitrust techniques; the Commission should examine the options available to customers and determine whether the utility possesses monopoly power in a relevant market.

[31,659]

Opposing Market-Based Rates for Existing Generation

Many commenters are concerned that even with open access tariffs certain generators will be able to exercise

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[135] *See also* Citizens Utilities.

[136] *See also* CSW, Industrial Energy Applications, Public Service Co of CO, Coalition for Economic Competition.

market dominance.[137] For example, NARUC argues that utilities retain market power through their ownership of existing generation and transmission facilities, favorable long-term contracts for fuel and other inputs, and access to superior generation sites.[138] NRECA believes that the universe of generation providers is still too narrow to assume a competitive market and that other factors, such as transmission constraints and pancaking of rates, will inhibit the development of competitive markets.[139] FTC says that, although comparable transmission access could broaden the relevant geographic market for generation, the Commission should not assume that there will be no market power. It says that the Commission must continue to evaluate each case.[140]

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[137]*E.g.*, NRECA, TDU Systems, MT Com, SMUD, NEPCO, Orange & Rockland, El Paso, American Forest & Paper, NIPSCO, AEC & SMEPA, OH Com, IL Com, IN Com, Legal Environmental Assistance, LG&E, Cajun, Industrial Energy Applications, LEPA, MA DPU, MI Com, FTC, Minnesota P&L, SC Public Service Authority, WP&L, NARUC, Canadian Petroleum Producers, DOD, CCEM, Environmental Action, American Wind, Cajun, NIEP, EGA, TAPS, ELCON, Consolidated Natural Gas.

[138]*See also* NIEP, Pacificorp, CA Energy Com.

[139]*See also* MT Com, TDU Systems, Soyland.

[140]*See also* AEC & SMEPA, NIPSCO, El Paso (discusses a particular transmission constraint that it states limits its access to suppliers).

NRECA is also concerned that mergers may create a handful of "mega-public utilities" that may affect a regional

TDU Systems argues that the Commission cannot move to market-based rates without a Congressional determination that deregulation of wholesale electric rates should be implemented. It further asserts that the Commission does not have a factual basis for a reasoned conclusion that regulated utilities do not have market dominance -- full open access is only a goal at this time, and the success of open access will depend upon the transmission rate structures the Commission approves.

LEPA raises concerns that the small bulk power suppliers, QFs, co-generators, EWGs, IPPs, and marketers (who provide non- requirements power) may not be able to bring competition to the wholesale market. LEPA concludes that "barriers will exist unless buyers have full access to requirements power itself, rather than just to the chance to acquire the individual components of requirements power."[141] TDU Systems raises concerns about the limited number of generation providers and the effect of possible future mergers. It also argues that pancaked rates raise the cost of transmission to third parties, thereby restricting the geographic scope of markets. As a result, TDU Systems asserts that individual generators in highly concentrated regions will still be able to exert market power. OH Com expresses concerns that restrictions on siting of generation and transmission will favor nearby generators. SC Public Service

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generation market and that the Commission should apply more traditional antitrust principles in analyzing the impacts of mergers.

[141]LEPA Initial Comments Affidavit of William G. Shepherd at p. 4.

Authority argues that if the Commission allows utilities to recover stranded costs their market power will not be mitigated, since customers will have to pay exit fees to switch suppliers.[142]

CCEM notes that in Order No. 636 gas pipelines were not allowed market-based rates for merchant sales until after transmission had been completely unbundled and non-discriminatory open access had been fully implemented.

DOE and DOJ assert that open access should not be assumed to mitigate market power sufficiently to justify deregulation of existing generation -- structural changes, such as control of the regional grid by an independent entity, are required. DOE requests that the Commission continue to look for affiliate abuse when reviewing market-based rates for new generation. Similarly, EPA is concerned that even with open access, individual generators may still exert market power by their domination of a particular geographic market. It is also concerned **[31,660]** that low-cost plants that are subject to weaker environmental standards could have a market advantage. NEPOOL Review Committee requests that the Commission not approve any market prices "where the market into which the seller proposes to sell is not effectively competitive due to the absence of regional transmission products and prices."[143]

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[142]*See also* DOD and WP&L. IL Com suggests that the Commission allow market-based rates to a utility on the condition that the utility forego stranded cost recovery.

[143]NEPOOL Review Committee Initial Comments at p. 28.

Commission Conclusion

While the Commission expects this Rule to facilitate the development of competitive bulk power markets, we find that there is not enough evidence on the record to make a generic determination about whether market power may exist for sales from existing generation. We continue to have concerns about how to define the relevant markets and believe that a more rigorous analysis is needed than can be achieved with the limited market data that is now available. We will continue our case-by-case approach that allows market-based rates based on an analysis of generation market power in first tier and second tier markets.[144] In particular cases, however, the effect of the mandatory open access prescribed by this Final Rule may lead to the consideration of geographic markets for the applicant's generation products that are broader in scope than the first-tier and second-tier markets currently considered.[145] By the same token, in some cases,

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[144]*See, e.g., Southwestern Public Service Company*, 72 FERC ¶61,208 at p. 61,996 (1995).

[145]The Commission's practice is to define the relevant markets as those utilities directly interconnected to the applicant (first-tier markets). For each first-tier market, we consider all utilities interconnected to the first-tier utility and all utilities interconnected to the applicant as competitors in that relevant market. Thus, the competitors include the second-tier utilities directly interconnected to the relevant market and those other first-tier utilities that can reach the market by virtue of the applicant's open access transmission tariff. *See, e.g., Kansas City Power & Light Company*, 67 FERC ¶61,183 at p. 61,556; and *Heartland Energy Services, Inc.*, 68 FERC ¶61,223 at p. 62,061.

evidence of the effects of transmission constraints may circumscribe the scope of the relevant geographic market for the applicant's generation products.

While we will continue to apply the first-tier/second-tier analysis, we will allow applicants and intervenors to challenge the presumption implicit in the Commission's practice that the relevant geographic market is bounded by the second-tier utilities. Thus, for instance, applicants may present evidence that the relevant market is in fact broader than the first or second tier. In support of such a contention, an applicant would need to show more than the existence of open access. For example, an applicant might attempt to demonstrate the lack of significant transmission constraints in the more broadly defined market and that cumulative transmission rates would not significantly affect the ability of more distant suppliers to compete in the relevant market. Similarly, an intervenor may present evidence that, due to the existence of significant transmission constraints within the first- and second-tier markets, the relevant market is in fact more limited in scope.[146]

Finally, we will maintain our current practice of allowing market-based rates for existing generation to go into effect subject to refund. To the extent that either the applicant or intervenors in individual cases offer specific evidence that the relevant geographic market ought to be defined differently than under the existing test, we will examine such arguments through formal or paper hearings.

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[146]*See Wisconsin Public Service Corporation*, 75 FERC ¶61, --, slip op. at pp. 6-7 (1996).

Because our goal is to develop more competitive bulk power markets, we will continue to monitor markets to assess the competitiveness of the market in existing generation, and we will modify our market rate criteria if and when appropriate. However, any changes we might make to our analysis for authorizing market-based rates in the future will not upset transactions entered into pursuant to existing market-based rate authority. The policies we put in place today to develop a smoothly functioning transmission access regime will provide useful experience and information for assessing the effects of generation concentration.

4. Merger Policy

In the NOPR, the Commission did not address possible ramifications of the **[31,661]** NOPR with regard to its existing merger policy.

Comments

A number of commenters suggest that the Commission should reevaluate its merger policy in light of the NOPR.[147] They further suggest a number of changes that they believe need to be made to the Commission's existing merger policy.

Most commenters raising this issue express concerns that mergers will lessen competition and hinder achievement of competitive bulk power markets.[148] For example, NRECA

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[147] *E.g.*, NRECA, TAPS, Wisconsin Coalition, APPA.

[148] *E.g.*, Wisconsin, Rosebud, NRECA, IN Com, Wisconsin Coalition, NIEP, Minnesota P&L, APPA.

indicates that the Commission's merger policy is at a crossroads. It believes that it is essential for the Commission to reevaluate its merger policy in concert with the proposed rulemakings.[149] Similarly, TAPS recommends that the Commission reevaluate its merger criteria to ensure that in a more competitive era, mergers are found to be consistent with the public interest only if they are pro-competitive. Several commenters argue that the Commission should continue to conduct a case-by-case investigation of the product and geographic markets that will be affected by a proposed merger.[150]

A number of commenters also suggest certain changes that they would like to see in the Commission's merger policy.[151] APPA recommends that, at a minimum, all merger approvals considered by the Commission should be conditioned on: (1) filing an open access transmission tariff, (2) demonstrating no market power in generation or ancillary services, and (3) granting all existing requirements customers of the merged entity the right to convert existing contracts to rights to equivalent transmission capacity. Several commenters suggest adopting the U.S. Department of Justice Merger Guidelines in analyzing merger proposals.[152]

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[149]*See also* APPA.

[150]*E.g.*, Wisconsin Coalition, MMWEC.

[151]*E.g.*, APPA, Wisconsin Coalition, Minnesota P&L, IN Com.

[152]*E.g.*, Wisconsin Coalition.

Environmental Action and others contend that merging utilities must be required to demonstrate real net benefits to retail and wholesale customers that could not otherwise be achieved but for the proposed merger.[153]

Commenters also argue that the Commission should use its merger conditioning authority to order divestiture of transmission and generation when required to ensure competition.[154] Environmental Action and NEPOOL Review Committee suggest conditioning merger applications on the existence of regional transmission pricing arrangements to mitigate any generation market power gained by the merging entities.

Commission Conclusion

The Commission appreciates the concerns and suggestions raised with respect to our merger policy. However, since the time the NOPR was issued (and comments received thereon), we issued a Notice of Inquiry on the Commission's merger policy in Docket No. RM96-6-000.[155] There we indicated that we will review whether our criteria and policies for evaluating mergers need to be modified in light of the changing circumstances, including this final rule, that are occurring in the electric industry. The NOI proceeding will permit us to consider comments from all

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[153]E.g., TAPS, Wisconsin Coalition.

[154]*E.g.*, NIEP, Wisconsin Coalition, TAPS, Environmental Action.

[155]*FERC Statutes and Regulations* ¶35,531 (1996).

interested participants and, at the same time, allow us to review our merger criteria and policies in light of this final rule. We are committed to reviewing our merger policy in a timely manner in the ongoing NOI proceeding.[156]

5. Contract Reform

In the NOPR, the Commission explained that it believed that it could remedy unduly discriminatory practices and achieve more competitive bulk power markets without abrogating existing **[31,662]** wholesale power supply contracts that bundle generation and transmission services and existing wholesale transmission contracts.[157] Thus, we proposed to apply the functional unbundling requirement only to transmission services under new requirements contracts, new coordination contracts, and new transactions under existing coordination contracts. However, the Commission did invite comment on whether it would be contrary to the public interest to allow all or some of the above types of existing contracts to remain in effect.

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[156]Our decision to review our merger policy in a separate NOI proceeding is not intended to affect a utility's business decision of whether a merger may be in the economic interest of its ratepayers and stockholders. The NOI proceeding will not prevent us from reviewing merger applications in as timely a manner as possible.

[157]*FERC Statutes and Regulations* ¶32,514 at p. 33,093.

Requirements and Transmission Contracts

Many of the commenters (including utility customers and third-party power suppliers) addressing this issue oppose abrogating existing contracts on a generic basis.[158] A number of the commenters contend that existing contracts should be retained because they are the result of mutually beneficial bargaining.[159] SMUD and TANC are concerned that existing contracts providing for transmission service that is superior to the pro forma tariffs not be abrogated.[160] Ohio Edison argues that existing contracts have contributed to the emergence of competition, meet the specific needs of the parties, have been approved by the Commission, and have not been found to be unduly discriminatory or violative of the public interest, and that their preservation is consistent with the Energy Policy Act, most notably amended section 211 of the FPA. PacifiCorp and AEP express concern that contract abrogation

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[158]*E.g.*, Dayton P&L, NSP, Montaup, Southwestern, Ohio Edison, Consumers Power, Allegheny, Public Generating Pool, NEPCO, Pennsylvania P&L, Southwest TDU Group, Arizona, DOD, El Paso, Florida Power Corp, AEC & SMEPA, Atlantic City, Texaco, Tampa, CSW, Central Illinois Public Service, CA Cogen, ConEd, GA Com, Consolidated Natural Gas, Ohio Valley, Pacific Northwest Coop, Salt River, Oglethorpe, Minnesota P&L, NYSEG, Brazos, Southern, Washington Water Power, CINergy, SoCal Edison, Hoosier EC.

[159]*E.g.*, AEC & SMEPA, Cajun, Carolina P&L, NSP, Pennsylvania P&L, UNITIL, Southwestern, CSW.

[160]*See also* Dairyland, DE Muni, Arkansas Cities, Ohio Valley.

would create competitive instability. American Forest & Paper argues that the Commission cannot refuse to honor existing contracts if it expects a competitive bulk power market to emerge.

Numerous commenters further argue that contract abrogation requires a fact-based, contract-specific evaluation, and they oppose any generic declaration that existing contracts are contrary to the public interest.[161] Some suggest that generic contract abrogation cannot be justified under the public interest standard.[162]

Missouri Basin MPA argues that the Commission should allow abrogation of existing wholesale power and transmission arrangements if the customer can demonstrate the undue competitive disadvantage caused by the arrangement.

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[161] *E.g.*, AEP, Associated EC, DOD, El Paso, NEPCO, Ohio Edison, PSNM, Southwest TDU Group, Utilities For Improved Transition, NYSEG, Citizens Utilities, NM Com, EGA. See also NRECA, TDU Systems, Blue Ridge, CCEM, Industrial Energy Applications, APPA, Cajun, Springfield, DE Muni, Missouri Basin MPA, TANC, Wolverine Coop Members, FL Com, Citizens Utilities, Soyland (support contract abrogation on a case- by-case basis).

[162] *E.g.*, Utilities For Improved Transition, NSP, Southwestern, DE Muni.

A few commenters support some form of generic contract abrogation.[163] CCEM asserts that existing wholesale requirements customers must be given the right to convert to transmission service under non-discriminatory open access tariffs.[164] CCEM notes that this is the same relief from undue discrimination that the Commission afforded to pipeline customers in Order Nos. 436 and 500.[165] CCEM emphasizes that here, in contrast to what occurred in the gas industry, "[c]onversion rights should be understood as the logical quid pro quo for introducing extra-contractual stranded-cost recovery rights into the wholesale requirements **[31,663]** contracts of electric utilities."[166] NRECA asserts that it would be unduly discriminatory to allow new transmission customers to use the open access transmission tariffs, but not allow existing customers the same access.[167]

TAPS says that if those who now have discriminatory contracts are forced to live with those contracts, a fully

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[163]*E.g.*, NRECA, CCEM, ELCON, DE Muni, Oglethorpe. Portland maintains that it would be in the public interest to abrogate existing contracts completely, but recommends that such action be taken only on a case-by-case basis.

[164]*See also* VT DPS, NYMEX.

[165]*See also* VT DPS, Portland.

[166]CCEM Initial Comments at p. 26. *See also* ELCON, VT DPS, Blue Ridge, NYMEX, OK Com, Missouri Basin MPA, Texas-New Mexico, TDU Systems.

[167]*See also* TDU Systems, Texas-New Mexico, TAPS, Wisconsin Municipals.

competitive market will be delayed considerably.[168] Moreover, TAPS argues, the Commission has a statutory duty to remedy the undue discrimination that it is only now recognizing. Even if the Commission will not abrogate these contracts across the board, TAPS asserts that we should use our section 206 authority to do so on a contract-by-contract basis.

San Francisco requests that the Commission clarify that a holder of capacity rights under an existing contract can extend contractual rights to transmission access at least coterminous with the life of the project and under a roll-over or renewal contract on the same basis as provided in the existing contract. Anoka EC proposes that when a wholesale purchaser's contract expires, it should have a right of first refusal to contract for the transmission capacity to which it previously had a right. Knoxville urges the Commission to require renegotiation of the notice and/or term of all existing contracts for which the voluntary termination period exceeds the time frame for implementation of the final rule.

NEPCO suggests that we require existing power contracts that allow rate changes to be separated into their generation and transmission components, without otherwise disturbing their terms; this would allow comparisons between

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[168] *See also* NorAm. UtiliCorp argues that existing contracts should not be allowed to extend indefinitely (as through "evergreen" clauses) without adopting comparability. *See also* Texaco, Wisconsin Municipals, Phelps Dodge.

the transmission service the utility provides to its power customers and the service it offers to others.[169]

Coordination Agreements

CINergy argues that coordination agreements should not be excluded from the comparability standard and that the Commission should use its authority under section 206 to require amendments to such agreements, just as it did in Order 636 in requiring unbundling of pipeline supply contracts. CINergy suggests that public utilities should be given up to three years to file the amendments to avoid hardship on the industry and the Commission's staff. CINergy further asserts that future transactions conducted under coordination agreements should be unbundled and the transmission component subjected to the comparable transmission service requirement.

Others argue that purchases under existing coordination agreements made on behalf of retail native load should not be unbundled.[170] NY Com and IL Com recommend that proposed §35.28(c) be modified to state that the functional unbundling requirement "exclude(s) those wholesale purchases made by the utility to serve existing or expected native retail load."

Utilities For Improved Transition disagrees with the idea that new transactions under existing coordination

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[169]*See also* Industrial Energy Applications.

[170]*E.g.*, Con Ed, Detroit Edison, IL Com.

agreements should be subject to the rule.[171] It argues that the sanctity of coordination contracts should be the same as for other contracts. Coordination contracts are not simply agreements to agree in the future, according to Utilities For Improved Transition; they set forth terms and rates and merely leave the timing of transactions to be resolved in the future. Moreover, it argues that the Commission has given no reason to abandon its practice of encouraging coordination sales by allowing price flexibility.

Commission Conclusion

Requirements and Transmission Contracts

We do not believe it is appropriate to order generic abrogation of existing requirements and transmission contracts. While the Commission did generically **[31,664]** find it appropriate to modify natural gas contracts to complete the move to a competitive commodity market in natural gas, we face a different situation here. At the time the Commission addressed this situation in the natural gas industry, it was faced with shrinking natural gas markets, statutory escalations in natural gas ceiling prices under the Natural Gas Policy Act, and increased production of gas.[172] In other words, there was a market failure in the industry that required the extraordinary measure of generically allowing all customers to break their contracts with pipelines.

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[171] *See also* Utility Workers Union, VEPCO.

[172] *See* Pierce, Richard J., *Reconstituting the Natural Gas Industry from Wellhead to Burnertip*, 9 Energy L.J. 1 (1988).

In contrast, there is no such market failure in the electric industry. Although changes in the industry have been and continue to be dramatic, we do not believe they compel generic abrogation of requirements and transmission contracts.[173]

While we have concluded that current conditions in the wholesale power market do not warrant the generic modification of requirements contracts, we conclude nonetheless that the modification of certain requirements contracts on a case-by-case basis may be appropriate. We conclude further that, even if customers under such contracts are bound by so-called Mobile-Sierra clauses, they nonetheless ought to have the opportunity to demonstrate that their contracts no longer are just and reasonable.

The Commission finds that it would be against the public interest to permit a Mobile-Sierra clause in an existing wholesale requirements contract to preclude the parties to such a contract from the opportunity to realize the benefits of the competitive wholesale power markets. For purposes of this finding, the Commission defines existing requirements contracts as contracts executed on or before July 11, 1994.[174]

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[173]In addition, we do not believe that unfavorable requirements contracts will derail the attainment of competitive wholesale power markets. Indeed, many of the commenters support this position and seek to retain their existing requirements contracts.

[174]This is consistent with the definition of existing requirements contracts we have used for purposes of stranded cost recovery.

By operation of this finding, a party to a requirements contract containing a Mobile-Sierra clause no longer will have the burden of establishing independently that it is in the public interest to permit the modification of such contract. The party, however, still will have the burden of establishing that such contract no longer is just and reasonable and therefore ought to be modified.

This finding complements the Commission's finding that, notwithstanding a Mobile-Sierra clause in an existing requirements contract, it is in the public interest to permit amendments to add stranded cost provisions to such contracts if the public utility proposing the amendment can meet the evidentiary requirements of this Rule.[175] The Commission's complementary Mobile-Sierra findings are not mutually exclusive. Any contract modification approved under this Section shall provide for the utility's recovery of any costs stranded consistent with the contract modification. The stranded costs must be prudently incurred, legitimate and verifiable, as provided in Section IV.J. Further, the Commission has concluded that if a customer is permitted to argue for modification of existing contracts that are less favorable to it than other generation alternatives, then the utility should be able to seek modification of contracts that may be beneficial to the customer.

The Commission believes that the most productive way to analyze contract modification issues is to consider simultaneously both the selling public utility's claims, if any, that it had a reasonable expectation of continuing to serve the

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[175] *See* Section IV.J.5.

customer beyond the term of the contract and the customer's claim, if any, that the contract no longer is just and reasonable and therefore ought to be modified. Thus, if the selling public utility intends to claim stranded costs, it must present that claim in any section 206 proceeding brought by the customer to shorten or terminate the contract. Similarly, if the customer intends to claim that the notice or termination provision of its existing requirements contract is unjust and unreasonable, it must present that claim in any proceeding brought by the selling public utility to seek recovery of stranded costs. This will promote administrative **[31,665]** efficiency and will permit the Commission to consider how the contracting parties' claims bear on one another.

The Commission does not take contract modification lightly. Whether a utility is seeking a contract amendment to permit stranded cost recovery based on expectations beyond the stated term of the contract, or a customer is seeking to shorten or eliminate the term of an existing contract, we believe that each has a heavy burden in demonstrating that the contract ought to be modified. Still, we believe that given the industry circumstances now facing us, both selling utilities and their customers ought to have an opportunity to make the case that their existing requirements contracts ought to be modified. By providing both buyers and sellers this opportunity, the Commission attempts to strike a reasonable balance of the interests of all market participants. The Commission expects that many of the arguments presented by buyers and sellers in such proceedings will be fact specific.

We note that because we are not abrogating existing requirements and transmission contracts generically and because the functional unbundling requirement of the Final

Rule applies only to new wholesale services, the terms and conditions of the Final Rule pro forma tariff do not apply to service under existing requirements contracts. However, if a customer's existing bundled service (transmission and generation) contract or transmission-only contract expires, and the customer takes any new transmission service from its former supplier, the terms and conditions of the Final Rule tariff would then apply to the transmission service that the customer receives.

A further issue concerning firm contract customers is their right to transmission capacity (and the rate for such capacity) when their contracts expire by their own terms or become subject to renewal or rollover. We have concluded that all firm transmission customers (requirements and transmission-only), upon the expiration of their contracts or at the time their contracts become subject to renewal or rollover, should have the right to continue to take transmission service from their existing transmission provider. The limitations are that the underlying contract must have been for a term of one-year or more and the existing customer must agree to match the rate offered by another potential customer, up to the transmission provider's maximum filed transmission rate at that time, and to accept a contract term at least as long as that offered by the potential customer.[176] This means that there is no right to grandfather

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[176]This right of first refusal exists whether or not the customer buys power from the historical utility supplier or another power supplier. If the customer chooses a new power supplier and this substantially changes the location or direction of its power flows, the customer's right to continue taking transmission service from its existing transmission provider may be affected by

the historical price of the transmission service. Thus, if not enough capacity is available to meet all requests for service, the right of first refusal gives the capacity to the existing customer who had contractually been using the capacity on a long-term, firm basis, assuming that it meets the conditions set forth above. Moreover, this limited right of first refusal is not a one-time right of first refusal for contracts existing as of the date of the final rule, but is an ongoing right that may be exercised at the end of all firm contract (including all future unbundled transmission contracts) terms. A customer converting existing bundled service to the Final Rule pro forma tariff would not have a reservation priority for capacity expansions, unless the existing contract provides for future transmission to the customer that requires capacity expansion.[177]

Finally, with respect to all existing requirements contracts and tariffs that provide for bundled rates, we will require all public utilities to make informational filings setting forth the unbundled power and transmission rates reflected in those contracts and tariffs. These informational rates must be submitted to the Commission within 60 days of publication of the Final Rule in the Federal Register and must also be included as a line item on all bills submitted to wholesale customers in the third month following the effective date of this final rule. The unbundled **[31,666]** informational rates will permit wholesale customers to compare rates in

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transmission constraints associated with the change.

[177]The above discussion on a right of first refusal addresses firm contract customers. However, the same logic applies to retail customers.

anticipation of their contracts expiring so that they can evaluate alternative contracts. Coordination Agreements

The situation as to coordination agreements requires a slightly different approach.[178] While we also believe that as a general matter it is important not to generically abrogate any coordination agreements, this is particularly true for non-economy energy coordination agreements that may reflect complementary long-term obligations among the parties. This type of agreement presents special problems and, as discussed below, we will not generically require this type of coordination agreement to be modified.[179]

Hundreds of coordination agreements exist in the industry today. Many are open-ended agreements that permit new transactions to occur well into the future. Because these contracts may not expire of their own terms in a reasonable

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[178]For purposes of this discussion, we define coordination agreements as all power sales agreements, except requirements service agreements. In addition, for purposes of implementing the non-discriminatory, open access requirements of the Final Rule, we are dividing bilateral coordination agreements into two general categories: (1) *Economy energy coordination agreements* are contracts and service schedules thereunder that provide for trading of electric energy on an "if, as, and when available" basis, but do not require either the seller or buyer to engage in a particular transaction; and (2) *non-economy energy coordination agreements* are any non-requirements service agreements, except economy energy coordination agreements.

[179]The requirements for power pools and other multilateral arrangements are discussed in detail in Section IV.F.

time, they may present a larger and more enduring obstacle to non-discriminatory open access and more competitive bulk power markets. Thus, to assure that non-discriminatory open access becomes a reality in the relatively near future, we will partially modify existing economy energy coordination agreements. We will condition future sales and purchase transactions under existing economy energy coordination agreements[180] to require that the transmission service associated with those transactions be provided pursuant to this Rule's requirements of non-discriminatory open access, no later than December 31, 1996.[181] We also will require that for new economy energy coordination agreements[182] where the transmission owner uses its transmission system to make economy energy sales or purchases, the transmission owner must take such service under its own transmission tariff as of the date trading begins under the agreement.[183]

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[180]Those executed prior to 60 days after publication of the Open Access Rule in the *Federal Register*.

[181]The requirement to unbundle future transactions under existing economy energy coordination agreements means that if the transmission owner uses its transmission system to make economy energy coordination sales or purchases, it must take service for these transactions under its own transmission tariff after December 31, 1996.

[182]Those executed 60 days after publication of the Open Access Rule in the *Federal Register*.

[183]Accordingly, transmission service needed for sales or purchases under *all* new economy energy coordination agreements will be pursuant to the Final Rule pro forma tariff.

Finally, we will treat non-economy energy coordination agreements differently. We will not require their modification. However, this does not insulate such agreements from complaints that transmission service provided under such agreements be provided pursuant to the Final Rule pro forma tariff.

With respect to coordination pricing practices, we conclude that non-discriminatory open access consistent with the requirements of this Rule is necessary if we are to allow utilities to continue to use market-driven pricing, such as split-the-savings pricing, for coordination sales. Absent such non-discriminatory open access, a utility would be able to deny access to others so as to obtain a higher price for its own power sales.

6. Flow-Based Contracting and Pricing

In the NOPR, the Commission discussed the procedures to be used in establishing Stage One rates. These Stage One rates were proposed as an administrative convenience. The proposal merely followed the long-established practice of establishing rates on the basis of contract **[31,667]** path pricing.[184] The Commission made no

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[184]A contract path is simply a path that can be designated to form a single continuous electrical path between the parties to an agreement. Because of the laws of physics, it is unlikely that the actual power flow will follow that contract path.

determination with respect to the appropriateness of flow-based pricing or contracting for other purposes.[185]

Most of the commenters addressing this issue recommend that industry or the Commission -- either in this rule or ultimately -- dispense with the traditional contract path basis for pricing and contracting. Most commenters also recommend that the Commission adopt or encourage a regional approach to the solution of transmission pricing problems, though they differ markedly in how to account for flows.[186]

Transmission customers generally seek to rid themselves of "pancaked" transmission rates that are associated with the traditional approach to transmission pricing.[187] They propose the development of regionwide transmission rates, perhaps determined on a pool or RTG

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[185]Flow-based pricing or contracting would be designed to account for the actual power flows on a transmission system. It would take into account the "unscheduled flows" that occur under a contract path regime. .

[186]*E.g.*, APPA, TAPS, NY Energy Buyers, Arcadia, Brownsville, Detroit Edison Customers, AMP-Ohio, Michigan Systems.

[187]*E.g.*, AMP-Ohio, NRECA, APPA, Detroit Edison Wholesale Customers, MMWEC, Missouri Basin MPA, Air Liquide, American Wind Energy, Associated Power, CCEM.

basis. Most, however, do not discuss how to account for unscheduled flows.[188]

Many transmission providers, some regulatory authorities, and some individuals strongly support flow-based pricing. Most of these commenters recognize a need for a regional approach to resolve transmission pricing concerns.[189] However, many of them also appear to accept contract pricing in the near term because of the need to implement open access quickly. [190]NERC recommends that the Commission maintain an open position on the transfer scheduling process and supports changes in the process to reflect actual power flows. EEI suggests that the Commission should be willing to deviate from a contract path approach, since competition may be accompanied by greater unscheduled flows and contract pricing is not well equipped to deal with such flows.

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[188]Some commenters propose the development of a regional rate on a postage stamp basis, without regard to distance travelled or the actual path of power flows. *E.g.*, Air Liquide, American National Power, CA Energy Co. Several commenters do, however, propose ways to account for unscheduled flows. *E.g.*, American Forest & Paper, DE Muni, Lower Colorado River Authority.

[189]*E.g.*, CSW, EDS Utilities, Dominion, CINergy, KS Com, CT DPUC, Com Ed, Hogan.

[190]NYMEX favors contract path pricing because of its familiarity and believes that the issue should primarily be resolved by the transmitting utilities. AEP believes that the primary responsibility lies with industry to develop alternative pricing structures.

However, EEI concludes that a single approach to pricing will not be appropriate for all systems.

Other commenters, however, do raise concerns with respect to flow-based pricing. AEC & SMEPA considers flow-based pricing to be flawed because that method makes an individual customer responsible for load flow effects caused by a third party's development of the third-party's transmission system over which the customer and its transmission provider had no control. Dayton P&L fears that competition would be lessened under flow- based pricing because utilities with large transmission systems would dominate the market.

Several commenters oppose Southern's and United Illuminating's flow-based proposals, arguing that the methodologies are based on estimates of actual flows or a set of conditions with limited applicability. Various commenters also believe that a single rate is flawed and could cause just as many problems as contract path pricing.[191]

Most commenters appear to believe that the Commission endorsed contract path pricing in the NOPR. Hogan expresses concern that many industry participants' understanding of the pro forma tariffs is based on the fiction of the contract path. The MT Dept of Environmental **[31,668]** Quality believes that despite the Commission's pledge to consider innovative pricing proposals,[192] such proposals will

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[191] *E.g.*, NU, NEPCO, BECO, Florida Power Corp.

[192] *See FERC Statutes and Regulations* ¶31,005.

receive heavy scrutiny, while conventional contract path pricing proposals will receive nearly automatic approval. Dominion is concerned that relying on the initiative of individual transmission owners to develop flow- based pricing will yield slow and patchy results.

Commission Conclusion

We will not, at this time, require that flow-based pricing and contracting be used in the electric industry. In reaching this conclusion, we recognize that there may be difficulties in using a traditional contract path approach in a non- discriminatory open access transmission environment, as described by Hogan and others. At the same time, however, contract path pricing and contracting is the longstanding approach used in the electric industry and it is the approach familiar to all participants in the industry. To require now a dramatic overhaul of the traditional approach -- such as a shift to some form of flow-based pricing and contracting -- could severely slow, if not derail for some time, the move to open access and more competitive wholesale bulk power markets. In addition, we believe it is premature for the Commission to impose generically a new pricing regime without the benefit of any experience with such pricing. We welcome new and innovative proposals, but we will not impose them in this Rule.

While we are not requiring the use of any form of flow-based pricing, we recognize that some versions of flow-based pricing could have benefits. For example, some versions of flow-based pricing could more accurately reflect and price the actual power flows on transmission systems and thus could produce efficiency gains, better generation siting

decisions, and benefits for customers and utilities alike. Other versions could more accurately assign capacity rights in accordance with a party's contribution to capacity costs.

These potential benefits, however, will not simply come about in the abstract. Flow-based pricing methodologies that will achieve the benefits sought by most of the participants in the industry are in a development stage and require further work and refinement to address some of the difficulties associated with flow-based approaches. Concurrent work on OASIS and resolving available transmission capability issues may help resolve flow-based issues. However, as demonstrated by the paucity of possible methodologies presented in the comments, developing workable methodologies will be difficult. As we explained in our Transmission Pricing Policy Statement, we are receptive to proposals for alternative rate methodologies, such as distance-sensitive and flow-based pricing, as long as the proposals are well supported. However, we have yet to receive a formal rate application for a flow-based pricing methodology that has been tested enough that it can be required on a generic basis. Thus, we have decided to go forward to achieve open access and more competitive wholesale bulk power markets without waiting for the development of a generic flow-based pricing methodology.

We wish to emphasize further that in taking this approach we are not endorsing the traditional contract path approach as the only available approach. We continue to approve contract path pricing because it is the long-established pricing method that comes to us in rate filings by the electric industry, is administratively convenient and feasible, and thus is a practical way to move forward now. We remain open to

alternative methodologies, but need to see better developed approaches from the industry before we can consider generic adoption of alternative pricing.

We also believe the adoption of flow-based pricing will be more practical on a regional, instead of individual utility, basis. Some forms of flow-based pricing may even require a regional approach. To this extent, regional ISOs could be a valuable mechanism for implementing such pricing reforms.

B. *Legal Authority*

The Commission reaffirms its conclusion in the NOPR that we have the authority under the FPA to order wholesale transmission services in interstate commerce to remedy undue discrimination by public utilities. We analyze below the relevant cases examining our wheeling authority, **[31,669]** then discuss and respond to the legal arguments raised by the commenters.

1. Bases for Legal Authority

a. Undue Discrimination/Anticompetitive Effects

In upholding the Commission's order requiring non-discriminatory open access in the natural gas industry, the court in Associated Gas Distributors v. FERC stated that the Natural Gas Act "fairly bristles" with concern for undue

discrimination.[193] The same is true of the FPA. The Commission has a mandate under sections 205 and 206 of the FPA to ensure that, with respect to any transmission in interstate commerce or any sale of electric energy for resale in interstate commerce by a public utility, no person is subject to any undue prejudice or disadvantage. We must determine whether any rule, regulation, practice or contract affecting rates for such transmission or sale for resale is unduly discriminatory or preferential, and must prevent those contracts and practices that do not meet this standard. As discussed below, AGD demonstrates that our remedial power is very broad and includes the ability to order industry- wide non-discriminatory open access[194] as a remedy for undue discrimination. The AGD court reached this decision even in the face of prior cases that acknowledged that Congress did not mandate common carriage or explicitly empower the Commission to order direct access for either gas transporters or electric utilities. Moreover, the Commission's power under the FPA "clearly carries with it the responsibility to consider, in appropriate circumstances, the anticompetitive effects of regulated aspects of interstate utility operations pursuant to

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[193]*Associated Gas Distributors v. FERC*, 824 F.2d 981, 998 (D.C.Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988) (AGD).

[194]We use the term "open access" to refer to a public utility's obligation to put a tariff on file offering service to eligible customers. Access is not open to all. Specifically, the tariff is not an offer to serve retail customers if state law does not permit retail wheeling.

(FPA) sections 202 and 203, and under like directives contained in sections 205, 206, and 207."[195]

Therefore, based on the mandates of sections 205 and 206 of the FPA and the case law interpreting the Commission's authority over transmission in interstate commerce, we conclude that we have ample legal authority -- indeed, a responsibility -- under section 206 of the FPA to order the filing of non-discriminatory open access transmission tariffs if we find such order necessary as a remedy for undue discrimination or anticompetitive effects.[196] We discuss below the primary court decisions that touch on our wheeling authority under sections 205 and 206.

The Commission's authority to order access as a remedy for undue discrimination under the Natural Gas Act (NGA) was upheld and discussed in detail in AGD. In AGD, the court upheld in relevant part the Commission's Order No.

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[195]*Gulf States Utilities Company v. FPC*, 411 U.S. 747, 758-59 (1973).

[196]In most situations, discrimination that precludes transmission access or gives inferior access will have at least potential anticompetitive effects because it limits access to generation markets and thereby limits competition in generation. Similarly, it is probable that any transmission provision that has anticompetitive effects would also be found to be unduly discriminatory or preferential because the anticompetitive provision would most likely favor the transmission owner vis-a-vis others.

436.[197] That order found the prevailing natural gas company practices to be "unduly discriminatory" within the meaning of section 5 of the NGA (the parallel to section 206 of the FPA) and held that if pipelines wanted blanket certification for their transportation services, they must commit to transport gas for others on a non-discriminatory basis; in other words, they must provide non-discriminatory open access.

In upholding the Commission's authority to require open access, the court first noted that the opponents' arguments against such authority must proceed "uphill." The statute contains no language forbidding the Commission to impose common carrier status on pipelines, let alone forbidding the Commission to impose "a specific duty that happens to be a typical or even core component of such status." The court found that the legislative **[31,670]** history cited by the opponents came nowhere near overcoming this statutory silence. Rather, the legislative history supported only the proposition that Congress itself declined to impose common carrier status.[198] Emphasizing Congress' deep concern with undue discrimination, the court found that the Commission had ample authority to "stamp out" such discrimination:

The issue seems to come down to this: Although Congress explicitly gave the Commission the power and the duty to achieve one of the prime goals of common carriage

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[197]Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, *FERC Statutes and Regulations* ¶30,665 (1985).

[198]*AGD*, *supra*, 824 F.2d at p. 997.

regulation (the eradication of undue discrimination), the Commission's attempted exercise of that power is invalid because Congress in 1906 and 1914 and 1935 and 1938 itself refrained from affixing common carrier status directly onto the pipelines and from authorizing the Commission to do so. And this proposition is said to control no matter how sound the Order may be as a response to the facts before the Commission. We think this turns statutory construction upside down, letting the failure to grant a general power prevail over the affirmative grant of a specific one.[199]

The AGD court found that court decisions under the FPA did not support the view that the Commission's authority to "stamp out" undue discrimination is hamstrung by an inability to require non-discriminatory open access as a remedy. These decisions are discussed below.

One of the earliest cases on wheeling is Otter Tail Power Company v. United States (Otter Tail).[200] In that case, the Supreme Court rejected the argument that the District Court, in a civil antitrust suit, could not order wheeling because to do so would conflict with the FPC's purported wheeling authority.[201] The Court explained that Congress had decided not to impose a common carrier obligation on the electric power industry and noted that the Commission was

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[199] *Id.* at p. 998.

[200] 410 U.S. 366 (1974).

[201] 410 U.S. at pp. 375-76.

not at that time expressly granted power to order wheeling.[202] In effect, it concluded that because Congress did not include common carrier provisions in the FPA, the Commission must not have any express authority to order wheeling that would preclude the District Court from imposing a wheeling remedy. Nowhere, however, did the Court say that the Commission lacked authority under section 206 to remedy undue discrimination. Indeed, that was simply not a matter before the Court or of any consequence to its decision.

In the FPA, while Congress elected not to impose common carrier status on the electric power industry, it tempered that determination by explicitly providing the Commission with the authority to eradicate undue discrimination -- one of the goals of common carriage regulation.[203] By providing this broad authority to the Commission, it assured itself that in preserving "the voluntary action of the utilities" it was not allowing this voluntary action to be unfettered. It would be far-reaching indeed to conclude that Otter Tail, which was a civil antitrust suit that raised issues entirely unrelated to our authority under section 206, is an impediment to our achieving one of the primary goals of the FPA -- eradicating undue discrimination in transmission in interstate commerce in the electric power industry.

In Richmond Power & Light Company v. FERC (Richmond),[204] the FPC, in reaction to the 1973 oil embargo,

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[202] *Id.* at pp. 374-76.

[203] *See AGD*, 824 F.2d at p. 998.

[204] 574 F.2d 610 (D.C. Cir. 1978).

was attempting to reduce dependence on oil. The FPC requested that utilities with excess capacity wheel power to the New England Power Pool (NEPOOL). In response, several suppliers and transmission owners filed rate schedules with the FPC that provided for voluntary wheeling. Richmond Power & Light Company (Richmond) objected to these filings, claiming that they were unreasonable because they did not guarantee transmission access. The FPC refused to compel the utilities to wheel Richmond's power, stating that it did not have the authority to order a public utility to act as a common carrier.

The D.C. Circuit upheld the Commission. It acknowledged that Richmond's argument was persuasive in some respects, **[31,671]** but stated that any conditions the Commission might impose could not contravene the FPA. The court examined the legislative history of the FPA and stated that "[i]f Congress had intended that utilities could inadvertently bootstrap themselves into common- carrier status by filing rates for voluntary service, it would not have bothered to reject mandatory wheeling * * *."[205]

However, the D.C. Circuit in no way indicated that the Commission was foreclosed from ordering transmission as a remedy for undue discrimination. Richmond also had argued that the alleged refusal of the American Electric Power Company (AEP) and its affiliate, Indiana & Michigan Electric Company (Indiana), to wheel Richmond's excess energy was unlawful discrimination because AEP and Indiana wheeled higher-priced electricity from other AEP affiliates. The court

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[205] *Id.* at p. 620.

acknowledged that Richmond's claim of unlawful discrimination was theoretically valid, but found that Richmond had failed to prove its case. It noted that if Richmond had argued that the rates were unjustifiably discriminatory, or that Indiana's failure to use its transmission capability fully or to purchase less expensive electricity for wheeling resulted in unnecessarily high rates, a different case would be before the court.[206] The case thus does not in any way limit the Commission's authority to remedy undue discrimination.

In Central Iowa Power Cooperative v. FERC,[207] the FPC[208] reviewed the terms of the Mid-Continent Area Power Pool (MAPP) Agreement under its section 205 and 206 authority. The agreement contained two membership limitations. First, the agreement established two classes of membership, with one class being entitled to more privileges than the other. Second, the agreement excluded non-generating distribution systems from pool services. The FPC found the first limitation on membership -- the two-class system -- to be unduly discriminatory and not reasonably related to MAPP's objectives. The FPC conditioned approval of the agreement under section 206 on the removal of the unduly discriminatory provision. The FPC found that the

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[206] *Id.* at p. 623, nn.53 and 57.

[207] 606 F.2d 1156 (D.C. Cir. 1979).

[208] While *Central Iowa* was pending, certain of the functions of the FPC were transferred to the FERC under the DOE Organization Act. Accordingly, the FERC was substituted for the FPC as the respondent in the case.

second limitation, the exclusion of non-generating distribution systems, was not anticompetitive and did not render the agreement inconsistent with the public interest.

On appeal, the D.C. Circuit affirmed the FPC's decision. The court found that the FPC did have authority to order changes in the scope of the MAPP agreement, if the agreement was unjust, unreasonable, unduly discriminatory or preferential under section 206 of the FPA. The court stated:

The Commission had authority, * * * under section 206 of the Act, * * * to order changes in the limited scope of the Agreement, including the addition of pool services, if, in the absence of such modifications, the Agreement presented "any rule, regulation, practice or contract (that was) unjust, unreasonable, unduly discriminatory or preferential."[209] However, the court agreed with the FPC's conclusion that the limited scope of MAPP was not unjust, unreasonable, or unduly discriminatory. The court recognized that a pool was not invalid under section 206 merely because a more comprehensive arrangement was possible.

The D.C. Circuit upheld the Commission's refusal to eliminate the second limitation on membership by ordering MAPP participants to wheel to non-generating electric systems.[210] However, neither the Commission nor the court was presented with the argument that wheeling was necessary as a remedy for undue discrimination.

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[209]606 F.2d at p. 1168.

[210]*Id.* at p. 1169; *see also Municipalities of Groton v. FERC*, 587 F.2d 1296 (D.C. Cir. 1978).

In Florida Power & Light Company v. FERC (Florida),[211] the Commission ordered Florida Power & Light Company (FP&L) to file a tariff setting forth FP&L's policy relating to the availability **[31,672]** of transmission service.[212] FP&L objected to including such a policy statement in its tariff and argued that the filing of such a policy would convert FP&L into a common carrier by obligating it to offer service to all customers.[213] There was no finding that the action ordered was necessary to remedy undue discrimination.

The Fifth Circuit Court of Appeals agreed with FP&L that the mandatory filing of the policy statement would require FP&L to provide transmission service beyond its voluntary commitment because such a requirement would

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[211]660 F.2d 668 (5th Cir. 1981), *cert. denied sub nom. Fort Pierce Utilities Authority v. FERC*, 459 U.S. 1156 (1983).

[212]FP&L provided transmission service when four conditions were met: (1) the specific potential seller and buyer were contractually identified; (2) the magnitude, time and duration of the transaction were specified prior to the commencement of the transmission; (3) it could be determined that the transmission capacity would be available for the term of the contract; and (4) the rate was sufficient to cover FP&L's costs.

[213]All utilities requesting wheeling services, subject to availability, would be entitled to receive transmission service under the filed terms. Any changes to a filed rate must be filed with the Commission. This is the so-called "filed rate doctrine." *See Northwestern Public Service Company v. Montana-Dakota Utilities Company*, 181 F.2d 19, 22 (8th Cir. 1980), aff'd, 341 U.S. 246 (1951).

change its duties and liabilities.[214] The Commission order would impose common carrier status on FP&L, the court found.[215] The court noted that the Commission did not rely on a finding of anticompetitive behavior and therefore the court did not address the Commission's power to remedy antitrust violations.[216]

The AGD court explicitly rejected the claim that the above line of cases establishes that the Commission lacks authority to require non-discriminatory open access.[217] Opponents of the Commission's order argued in AGD that Richmond and Florida, supra, stand for the proposition that the Commission cannot indirectly do what it allegedly cannot do directly, that is, impose common carriage. The AGD court

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[214]Under the filed rate doctrine, a refusal to wheel would be unduly discriminatory under section 206 of the FPA. As the court acknowledged, a customer refused service could petition the Commission to find that FP&L's policy of availability was unduly discriminatory under section 206(a) of the FPA. The court said that in the absence of a tariff on file, a utility refused wheeling services would be unable to claim discrimination under section 206(a) of the FPA. 660 F.2d at p. 675 (expressing "serious doubts that such a petition would be successful in the absence of a tariff").

[215]*Id.* at p. 676.

[216]*Id.* at p. 678.

[217]The AGD court did not address *New York State Electric & Gas Corporation v. FERC*, 638 F.2d 388 (2d Cir. 1980), cert. denied, 454 U.S. 821 (1981) (NYSEG), presumably because that case did not concern whether the Commission could order wheeling as a remedy for undue discrimination.

rejected these arguments, stating that the petitioners read the electric cases far too broadly:

(n)either Richmond nor Florida comes anywhere near stating that the Commission is barred from imposing an open-access condition in all circumstances.[218]

The court noted that the Florida case had expressly left open the question of whether the Commission would be entitled to use an open access condition as a remedy for anticompetitive conduct, and that in Richmond the D.C. Circuit had said little more than that unwillingness to transmit for all could not be automatically deemed undue discrimination. The court also noted the Central Iowa case, supra, in which it had upheld a Commission order that found a power pooling agreement discriminatory on its face because the agreement gave one class of membership privileged status over another. The court stated that the Central Iowa case "upholds the power of the Commission to subject approval of a set of voluntary transactions to a condition that providers open up the class of permissible users."[219] The court added that it refused to "turn statutory construction upside down" by letting Congress' failure to grant a general power of common carriage prevail over the affirmative grant of the specific power to eradicate undue discrimination.[220]

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[218]824 F.2d at p. 999

[219]*Id.* at p. 999.

[220]*Id.* at p. 1006.

We conclude that AGD's analysis of undue discrimination under sections 4 and 5 of the Natural Gas Act is equally applicable to an undue discrimination analysis under sections 205 and 206 of the **[31,673]** FPA. The Commission and courts have long recognized that the NGA was patterned after the FPA and that the two statutes should be interpreted in the same manner.[221] Thus, we conclude that we have the authority to remedy undue discrimination and anticompetitive effects by requiring all public utilities that own, control or operate transmission facilities to file non-discriminatory open access transmission tariffs.

b. Section 211 of the Federal Power Act

In concluding that we must invoke our section 206 authority to remedy undue discrimination and anticompetitive effects in the electric industry, we have carefully considered the goals of Title VII of the Energy Policy Act, and whether section 211 of the FPA, by itself, is sufficient to remedy undue discrimination in public utility transmission services. Title VII of the Energy Policy Act, which amended section 211 of the FPA to give the Commission broader authority to order wheeling in the public interest on a case-by-case basis, reflects the intent of Congress to encourage competitive wholesale electric markets. Section 211 provides a means for

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[221] *See, e.g., FPC v. Sierra Pacific Power Company*, 350 U.S. 348, 353 (1956); *Arkansas Louisiana Gas Company v. Hall*, 453 U.S. 571, 577 n.7 (1981); and *Kentucky Utilities Company v. FERC*, 760 F.2d 1321, 1325 n.6 (D.C. Cir. 1985). Section 206 of the FPA was recently revised and now differs from section 5 of the NGA, but not in a manner significant to our discussion here. See 16 U.S.C. 824e(b) and (c).

wholesale power sellers and buyers to obtain transmission services necessary to compete in, or to reach, competitive markets, and is a valuable tool to encourage competitive markets. However, in amending section 211, Congress left unaltered the authorities and obligations of the Commission under sections 205 and 206 (similar to our authorities and obligations under sections 4 and 5 of the NGA) to remedy undue discrimination. In addition, as discussed below, reliance on section 211 alone in some circumstances can result in the perpetuation of, rather than the elimination of, undue discrimination and anticompetitive effects.

First, there are inherent delays in the procedures for obtaining service under section 211. However, for competitive reasons, many transactions must be negotiated relatively quickly. Many competitive opportunities will be lost by the time the Commission can issue a final order under section 211. Case-by-case section 211 proceedings are not a substitute for tariffs of general applicability that permit timely, non-discriminatory access on request.

Second, discrimination is inherent in the current industry environment in which some customers and sellers are served by open access systems, and others have to rely on negotiated bilateral arrangements or the mandatory section 211 process. The end result is discrimination in the ability to obtain transmission services, as well as in the quality and prices of the services. This national patchwork of open and closed transmission systems, with disparate terms and conditions of service, cannot be cured effectively through section 211.

The Commission believes that its actions under sections 205 and 206 will complement the section 211 procedures to achieve both the Energy Policy Act's goals of creating more competitive bulk power markets and lower rates for consumers and the Federal Power Act's explicit direction in section 205(b) that no public utility shall, with respect to any transmission in interstate commerce, grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage.

2. Response to Commenters Opposing our Legal Authority

a. Authority to Order Open Access Tariffs

Initial Comments Supporting Commission Authority

A number of commenters support or state that they do not oppose the Commission's authority to order open access tariffs.[222] NIEP and CCEM explain that the AGD decision supports the Commission's action in this proceeding. ELCON asserts that the Commission's "extensive treatment of the relevant case law demonstrating FERC's authority to remedy this discrimination is legally sound." UtiliCorp argues that section 211 supports, rather than undermines, the Commission's **[31,674]** authority for the NOPR because it reflects Congress's intention to encourage more competitive bulk power markets.

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[222]NIEP, ELCON, CINergy, UtiliCorp, TAPS, SBA, Entergy, NY Energy Buyers, Sierra.

Initial Comments Opposing Commission Authority

Other commenters assert that the Commission has improperly relied on sections 205 and 206 of the FPA to require open access.[223] They argue, for instance, that Otter Tail should be read as a broad constraint on the Commission's authority to order wheeling for any purpose and that the AGD decision does not undermine that holding or the cases following Otter Tail.[224] In support, some of these commenters discuss Richmond Power & Light, New York State Electric & Gas Corporation, and Florida Power & Light Company, the same cases discussed by the Commission in the NOPR.[225]

For example, EEI highlights the AGD court's discussion noting the difference between the legislative history of the NGA and that of the FPA, which the court stated was not as strong as that of the NGA. Moreover, EEI argues that the court found that section 7 of the NGA provided support for the Commission's actions in Order No. 436 and that such section 7 conditioning authority is lacking under the FPA. Allegheny notes that AGD did not overrule Otter Tail. Dayton P&L states that, in the gas case, the Commission was

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[223]*E.g.*, EEI, Atlantic City, Allegheny, VA Com, PA Com, Ohio Edison, Southern, Utilities For Improved Transition, Dayton P&L, SCE&G, Centerior, BG&E, Central Hudson, NY Com, Salt River, Carolina P&L, Union Electric, VEPCO, Utility Workers Union.

[224]EEI, VA Com, Union Electric.

[225]E.g., EEI, VA Com, NY Com, PA Com, Salt River, Southern, Dayton P&L, Detroit Edison, BG&E.

responding to voluntary filings by pipelines. It also says that before the NOPR, the Commission itself saw its authority as more limited. SCE&G points to differences between Commission jurisdiction over public utilities and gas pipelines and criticizes the Commission's alleged assumption that the circumstances involved in the gas and electric industries are virtually identical.

PA Com argues that the attempt to analogize to the NGA and the cases that refer to that Act is inconsistent with the technical and engineering realities of the electric transmission grid and that extensive comparisons between the natural gas industry and the electric industry are misleading.[226]

FL Com argues that, in relying on sections 205 and 206 to establish generic open access transmission tariffs for all public utilities, the Commission violates the court's decision in Cajun Electric Power Cooperative v. FERC, 28 F.3d 173 at 179 (D.C. Cir. 1994), where, FL Com argues, the court refused to allow the Commission to use a non-evidentiary ruling when there were material facts at issue.

Reply Comments

CCEM responds that EEI and others confuse the obligations of a common carrier with the duty of public utilities not to unduly discriminate. It says that AGD supports the Commission's authority because the legislative history of

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[226]See also NY Com (NGA has no parallel provision to section 211 of the FPA), Salt River.

the FPA and the NGA are similar with respect to common carriage. According to CCEM, early versions of both statutes would have made the regulated industries operate as common carriers (citing Otter Tail, the legislative history of the FPA, the legislative history of the Public Utility Holding Company Act, and the legislative history of the Mineral Leasing Act), but that Congress chose not to impose the common carrier obligations.

CCEM also says that the duties the Commission imposed on the gas industry and those in the NOPR are not common carriage in any event. According to CCEM, a common carrier must carry all goods offered (citing Am. Trucking Assoc. v. Atchison, T. & S.F. Ry. Co., 387 U.S. 397, 406 (1967)). Finally, CCEM cites Stephenson v. Binford, 287 U.S. 251, 265-66 (1932), where the Supreme Court held that obligations that are typical of common carriers can be imposed on contract motor carriers.

CCEM further disagrees with EEI's argument that the enactment of section 211 was a disavowal of any other Commission authority to order transmission.

[31,675]

ELCON also disagrees with EEI's claim that the Energy Policy Act undermines the Commission's pre-existing section 205 and 206 authority. It states that the savings clause in section 212(e) of the FPA, as amended, explicitly expresses Congress' intention not to undermine the Commission's pre-existing authority and that the legislative history contains nothing to suggest otherwise.

Similarly, in response to those who argue that section 211 is the only source of authority for the Commission to order transmission, NIEP argues that sections 211 and 212 serve purposes different from section 206. It says that the Commission's authority to order transmission in the "public interest" under sections 211 and 212 is not synonymous with its authority to order transmission as a remedy for undue discrimination under section 206; the two standards are complementary but distinct:

> Although broadly applicable, the Commission's ability to order wheeling under Sections 211 and 212 is carefully limited by a number of procedural provisions. Foremost among these is the requirement that the wheeling may be ordered only upon a specific application for transmission services. FERC's authority to act in the public interest is thus confined to the individual case.
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> By contrast, FERC's remedial powers under Section 206 can be exercised upon a finding of unjust, unreasonable or unduly discriminatory or preferential practices. Once that finding has been made, however, the form and substance of the remedy is left entirely to the FERC's discretion. If FERC deems it necessary, FERC may adopt generally applicable rules or practices as a countermeasure to discriminatory acts, including ordering utilities to file generally applicable transmission tariffs.[227]

NIEP also points out that the legislative history does not address the Commission's authority to order transmission

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[227]NIEP Reply Comments at p. 8.

as a remedy for undue discrimination. It challenges the interpretation of the legislative history advanced by some commenters.[228]

Next, NIEP defends the Commission's proposed findings that there is generally undue discrimination in the provision of transmission service. It notes that when an agency acts on an industry-wide basis, the agency does not have to make a finding as to each particular case.

Finally, NIEP responds to those who argue that AGD is not on point. It notes that the AGD court discussed electric cases and emphasizes the court's statement that the NGA "fairly bristles with concern for undue discrimination" -- a statement that is equally true of the FPA.

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[228]NIEP explains that

> (W)hile much has been made of the Senate report accompanying S.2114, which subsequently became part of PURPA in 1978, that report does not illustrate an intent to limit FERC's authority to remedy undue discrimination under Section 206. That report characterizes the Supreme Court's decision in Otter Tail as holding that "the Federal Power Act leaves open a gap in its failure to assign the FPC general authority to order wheeling in this situation * * *." The "situation" to which the Report refers is not discrimination, however. Instead, the statement appears to make reference to circumstances in which general public interest concerns, such as reliability, efficiency and competition, are at stake. Thus, Senate Report 2114 is simply not a limitation on the Commission's remedial powers under Sections 206.
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> NIEP Reply Comments at p. 8-9 (citations omitted).

TDU Systems responds to the argument that Otter Tail is a broad constraint on the Commission's authority to order transmission.[229] At issue in that case, it argues, was the reach of the Sherman Act, not of FPA sections 205 and 206. Similarly, it argues, the Florida Power case is not on point, and the court there specifically said that it was not deciding whether the Commission could have ordered wheeling as a remedy for anticompetitive activities. Moreover, TDU Systems asserts that EEI's use of a quote from a single Senator should carry no weight, since it is a well-established principle of statutory construction that such statements have little value. Finally, it points out that the AGD court itself did not view Otter Tail or other electric precedent as forbidding the Commission to order wheeling as a remedy for undue discrimination.

[31,676]

Entergy asserts that Congress's refusal to require utilities to provide transmission as common carriers or whenever it is in the public interest was merely a decision not to give the Commission general authority to order wheeling, without regard to undue discrimination. Thus, the Otter Tail language concerning the absence of a common carrier requirement does not demonstrate that Congress meant to limit the Commission's authority to remedy undue discrimination.

ELCON disputes EEI's reading of NYSEG, noting that the NYSEG court explicitly stated:

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[229]See also Entergy.

Nor do we suggest that the Commission is powerless to review a wheeling agreement under 206 without following the requirements of sections 211 and 212.[230]

TAPS discusses numerous cases, including the primary cases relied upon by the Commission, and disposes of NYSEG by stating that it is no longer good law, if it ever was.

Commission Conclusion

There can be no question that the Commission has the authority to remedy undue discrimination. Sections 205 and 206 of the FPA mandate that we ensure that, with respect to any transmission in interstate commerce or any sale of electric energy for resale in interstate commerce by a public utility, no person is subject to any undue prejudice or disadvantage. Under these sections, we must determine whether any rule, regulation, practice, or contract affecting rates for such transmission or sale for resale is unduly discriminatory or preferential, and we must disapprove those contracts and practices that do not meet this standard. Our discretion is at its zenith in fashioning remedies for undue discrimination.[231]

Some commenters, however, challenge our authority to order industry-wide non-discriminatory open access as a remedy for the undue discrimination we have found in the

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[230]ELCON Initial Comments at p. 7 (quoting NYSEG at 403).

[231]See, *e.g.*, Niagara Mohawk Power Corporation v. FPC, 379 F.2d 153, 159 (D.C. Cir. 1967).

industry. As summarized above, they essentially assert that we are prohibited by court precedent, the legislative history of the FPA, and sections 211 and 212 of the FPA from ordering wheeling as a remedy for undue discrimination. We disagree and conclude that we have the authority -- indeed, a responsibility -- to require non-discriminatory open access transmission as a remedy for undue discrimination.

AGD and Legislative History

The court decision in Associated Gas Distributors v. FERC provides powerful support for our ability to order industry-wide non-discriminatory open access transmission in the electric industry as a remedy for undue discrimination. As discussed in detail above, AGD, which is the only decision to have addressed the Commission's authority to remedy undue discrimination by requiring open access, upheld our authority under section 5 of the NGA (the parallel to section 206 of the FPA) to require open access in the natural gas industry. The rationale supplied by the AGD court applies equally to the FPA and our responsibility to eliminate undue discrimination in the electric industry.

Those who challenge the Commission's legal authority to remedy undue discrimination face the same difficulty that parties faced in seeking to overturn open access in the natural gas industry -- they "can point to no language in the (FPA) barring the Commission from imposing common carrier status on (public utilities), and certainly none barring it from imposing upon the (public utilities) a specific duty that happens to be a typical or even core component of such

status."[232] Instead, as was unsuccessfully attempted in the AGD proceeding, they seek to overcome the statutory silence primarily by means of legislative history. However, as the AGD court explained, legislative history is not even relevant, because

courts have no authority to enforce principles gleaned solely from legislative history that has no statutory reference point.[233] Here, as the court found with respect to the NGA, the legislative history of the FPA "provides strong support only for the point that Congress declined itself to impose common carrier status on (public utilities) * * * It affords weak -- **[31,677]** almost invisible -- support for the idea that the Commission could under no circumstances whatsoever impose obligations encompassing the core of a common carriage duty."[234]

Commenters focus on the following statement in the AGD decision to support the argument that, because Congress did not expressly reject common carriage under the NGA, but did reject it under the FPA, a different outcome in this proceeding is required:

we note that the legislative history of the two acts is, on this point, materially different. In its deliberations on the bill that

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[232]AGD, 824 F.2d at 997.

[233]*Id.* (quoting IBEW, Local No. 474 v. NLRB, 814 F.2d 697, 712 (D.C. Cir. 1987)(emphasis deleted by court from original)).

[234]*Id.* (emphasis added).

ultimately emerged as the Federal Power Act, Congress considered and rejected a provision that would have "empowered the Federal Power Commission to order wheeling if it found such action to be 'necessary or desirable in the public interest.'" (citing Otter Tail) (quoting S. 1725, 74th Cong., 1st Sess.). The evidence as to the NGA (surveyed above) is less direct: it consists exclusively of various occasions on which Congress did not adopt proposals actually making the natural gas pipelines into common carriers.[235]

The above statement, however, does not preclude the AGD court's decision on our broad authority to remedy undue discrimination in the gas industry from applying equally in the electric industry. Clearly, the court did not say that. As discussed below, we believe the statement focuses on a distinction in the legislative histories that is not meaningful.

First, whether or not a material difference exists in the respective legislative histories of the NGA and FPA, the fact remains that the crucial findings of the AGD court were that: (1) "Congress declined itself to impose common carrier status" (emphasis added) and (2) there is no "support for the idea that the Commission could under no circumstances whatsoever impose obligations encompassing the core of a common carriage duty."[236] These findings apply equally to the

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[235] *Id.* at p. 998-99.

[236] *Id.* at p. 997. We also note that the contract carriage obligation we are imposing is easily distinguished from the common carrier obligation Congress chose not to adopt. As discussed infra, the common carrier provisions rejected by Congress would have required transmission for "any person" upon reasonable request.

FPA. Simply stated, statutory silence cannot be overcome by means of legislative history -- even if the legislative history in fact indicated that Congress "rejected" legislative imposition of common carrier status under the FPA, but "did not adopt" it under the NGA. In either event, nothing in the statute or legislative history suggests that Congress concluded that the Commission could under no circumstances impose open access as a remedy to undue discrimination.

Moreover, the legislative history of the bills containing the FPA and the NGA, taken as a whole, suggests that the distinction drawn in AGD between the legislative histories of the NGA and the FPA is not meaningful. The legislation that was to become the FPA originally included provisions regulating both electric power and natural gas. As originally proposed, the legislation contained identical common carriage language for both public utilities and natural gas pipelines.

With respect to the FPA, the Supreme Court explained in Otter Tail that (a)s originally conceived, Part II would have included a "common carrier" provision making it "the duty of every public utility to * * * transmit energy for any person upon reasonable request * * *." In addition, it would have empowered the Federal Power Commission to order wheeling if it found such action to be "necessary or desirable in the public interest." H.R. 5423, 74th Cong., 1st Sess.; S. 1725, 74th Cong. 1st Sess. These provisions were eliminated to preserve "the voluntary action of the utilities." S.Rep. No.

This would have included retail purchasers.

621, 74th Cong., 1st Sess., 19.[237] The language paraphrased by the Supreme Court was from Title II of the initial bill proposing the Public Utility Holding Company Act. The entire sections from which the paraphrased language came are as follows:

SEC. 202. (a) It shall be the duty of every public utility to furnish energy to, exchange energy with, and transmit energy for any person upon reasonable request therefor; and to furnish and maintain such services and facilities as **[31,678]** shall promote the safety, comfort, and convenience of all its customers, employees, and the public, and shall be in all respects adequate, efficient, and reasonable.

* * *

SEC. 203. (b) Whenever the Commission after notice and opportunity for hearing finds such action necessary or desirable in the public interest, it may by order direct a public utility to make additions, extensions, repairs, or improvements to or changes in its facilities, to establish physical connection with the facilities of one or more other persons, to permit the use of its facilities by one or more other persons, or to utilize the facilities of, sell energy to, purchase energy from, transmit energy for, or exchange energy with, one or more other persons. Where any such order affects two or more persons, the Commission may prescribe the terms and conditions of the arrangement to be made between such persons, including the apportionment of

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[237]Otter Tail, 410 U.S. at p. 374.

cost between them and the compensation or reimbursement reasonably due to any of them.[238]

This initial bill proposing the Public Utility Holding Company Act also included a Title III that was intended to regulate the transmission and sale of natural gas. Sections 303(a) and 304 of Title III included the identical common carrier language paraphrased by the Supreme Court and included in sections 202(a) and 203(b) of Title II.[239] After further deliberations, Congress rejected the above-quoted language in Title II and eventually adopted a Title II that did not include any common carrier language. On the other hand, Title III (addressing regulation of natural gas) was not reported out of committee, but reemerged in the next year.[240]

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[238]H.R. 5423, 74th Cong., 1st Sess., 32 (emphasis added).

[239]*Id.* at p. 44.

[240]In the debate on the subsequent bill to regulate natural gas, Congressman Cole explained:

Mr. Chairman, the House should realize that the measure we are dealing with today is of extreme importance, more so than the attendance and the time taken in the discussion would seem to indicate. It is the culmination of one of the most far-reaching, intensive studies of the Federal Trade Commission I assume that that Commission ever conducted, and last year found a place in not identical language but very similar in the Rayburn bill, the famous holding-company bill, as part 3 thereof. Our committee eliminated part 3, as members will recall, and saved it for a separate measure reported out as it was last year, which was not considered by the House, but is here today in improved form. 81 Cong. Rec. H6724 (daily ed. July 1, 1937).

The bill that reemerged did not contain the common carrier language that was in the original Title III. However, as Congress had just debated the common carrier issue in enacting electric power regulation, it is not surprising that Congress did not engage in debating the very same issue in enacting natural gas regulation.

Because of the timing of the legislation involving the FPA and the NGA and the logical nexus between the two acts, we conclude that there is in fact no material difference as to this issue in the legislative histories of the two acts. Both initially included identical common carrier language, and the language was removed from both. As to both acts, Congress chose not to impose common carrier obligations on the electric or natural gas industries, but gave the Commission the authority and responsibility to eliminate undue discrimination in both industries. Consequently, as open access was found to be a proper remedy for undue discrimination in the natural gas industry, it is also a proper remedy for undue discrimination in the electric industry.

As the AGD court noted with respect to the Commission's powers and duties under the NGA, Congress explicitly gave the Commission the authority to eradicate undue discrimination under the FPA. That explicit power and duty provided by Congress cannot be invalidated solely on the ground that Congress chose not to impose statutory common carrier status on public utilities or did not explicitly authorize the Commission to do so.[241] As the AGD court explained, this would "turn[] statutory construction upside down, letting the

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[241] AGD, 824 F.2d at p. 998.

failure to grant a general power prevail over the affirmative grant of a specific one."[242]

[31,679]
Other Case Law

A number of commenters argue that the Commission misinterpreted the other cases discussed in the NOPR with respect to our authority to order non-discriminatory open access transmission. We disagree. As demonstrated above, not one of the cases put forth by commenters holds that we cannot remedy undue discrimination by requiring public utilities to provide non-discriminatory open access transmission.[243]

AGD is the only case in which a court specifically addressed our authority to order open access transmission as a remedy for undue discrimination. Its favorable finding with respect to our action under section 5 of the NGA directly supports our ordering non-discriminatory open access transmission under section 206 of the FPA. Authority to Act by Rule

We disagree with those commenters that assert that we may find and remedy undue discrimination only through case-

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[242] *Id.*

[243] See *FERC Statutes and Regulations* at p. 33,053-56. We further note that the AGD court did not discuss the NYSEG decision at all. Indeed, the NYSEG case did not involve any allegations of undue discrimination and any discussion of section 206 by the court was dictum.

by-case adjudications and are prohibited from making a generic determination of undue discrimination through a rulemaking. First, there is no question that it is within our discretion whether we act through rule or through case-by-case adjudications.[244] The AGD court specifically rejected a similar argument that the Commission erred in requiring open access transportation tariffs without first finding that each individual pipeline's rates were unlawful. The AGD court held that "(t)he Commission is not required to make individual findings if it exercises its §5 authority by means of a generic rule."[245]

We have identified a fundamental generic problem in the electric industry: owners, controllers and operators of monopoly transmission facilities that also own power generation facilities have the incentive to engage, and have engaged, in unduly discriminatory practices in the provision of transmission services by denying to third parties transmission services that are comparable to the transmission services that they are providing, or are capable of providing, for their own power sales and purchases. These practices

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[244]*See, e.g., NLRB v. Bell Aerospace Company*, 416 U.S. 267, 293 (1974) (citing *SEC v. Chenery Corporation*, 332 U.S. 194, 202-03 (1947). *See also Heckler v. Campbell*, 461 U.S. 458, 467 (1983) (even where enabling statute requires a hearing to be held, agency may rely on its rulemaking authority); *Panhandle Eastern Pipeline Company v. FERC*, 907 F.2d 185, 187-88 (D.C. Cir. 1990). Under section 403 of the DOE Act, 42 U.S.C. 7173, the Commission is authorized at its discretion to initiate rulemaking proceedings.

[245]AGD, 824 F.2d at p. 1008.

drive up the price of electricity and hurt consumers. Furthermore, the incentive to engage in such practices is increasing significantly as competitive pressures grow in the industry. It is within our discretion to conclude that a generic rulemaking, not case-by-case adjudications, is the most efficient approach to take to resolve the industry-wide problem facing us.

b. Undue Discrimination/Anticompetitive Effects Initial Comments

A number of commenters allege that the Commission has failed to meet its burden of proving industry-wide discrimination.[246] They assert that the Commission has provided only a few unsubstantiated allegations of discrimination, which do not represent the current conditions in the electric industry, or that the Commission has not shown that all electric utilities have unduly discriminated. Some attack the NOPR's incorporation by reference of the unsubstantiated allegations of discrimination set forth in a petition for rulemaking filed on February 16, 1995 by the Coalition for a Competitive Electric Market (CCEM).[247]

EEI argues that the allegations of discrimination in the NOPR must be considered in light of the fact that: (1) all tariffs currently on file have been found by the Commission not to be discriminatory; (2) more than 30 utilities have voluntarily filed open access tariffs, which belies any

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[246]E.g., EEI, Ohio Edison, PA Com, BG&E, NY Com, Minnesota P&L, Carolina P&L.

[247]E.g., EEI, BG&E.

assertion of widespread discrimination in the industry; and (3) transmission disputes are rare, with only 19 **[31,680]** section 211 proceedings having been filed in the last three years.[248] EEI concludes that the Commission's allegations of discrimination do not rise to the level of "extreme circumstances" found by the court in the natural gas industry in AGD.

EEI adds that the Commission's proposal to act under section 206 is itself discriminatory because it applies only to public utilities and does not reach all transmission-owning utilities.[249] If reciprocity is designed to resolve this problem, EEI believes that reciprocity should also be "effective for public utilities." Furthermore, EEI argues that the failure of a public utility to provide to others a service that it does not provide itself is not evidence of discrimination, and that inclusion of such a provision actually results in preferential treatment for transmission users.

NE Public Power District alleges that the NOPR does not contain a single reference to any actual discrimination or anticompetitive conduct by any publicly owned utility.

Salt River asserts that the Commission is required to consider all elements of an antitrust analysis before reaching a conclusion that market power exists in the transmission

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[248]See also Ohio Edison.

[249]See also SCE&G.

system and that we have failed to do so.[250] It concludes that the NOPR "constitutes an attempt to legislate a remedy for an evil that has not been, and cannot be, lawfully found to exist on a wholesale basis among utilities that own and operate integrated generation and transmission systems."[251]

PA Com argues that the Commission's request for examples of discriminatory behavior is a "tacit admission as to the paucity of evidence of discriminatory practices by transmission owning utilities." NY Com argues that the "Commission's lack of a record basis for its proposed findings is legally suspect because courts in two cases have held that the Commission cannot proceed with open access transmission tariffs absent record findings of specific anticompetitive conduct."[252]

Finally, EEI claims that even if the Commission has proven its allegations of discrimination, we have failed to meet the requirements of section 206 of the FPA.[253] According to EEI, the Commission cannot find, without an adjudicatory hearing, that the rates on file are unlawful and

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[250]Salt River Initial Comments at p. 5-6 (referencing an attached legal memorandum of Donald A. Kaplan).

[251]Salt River Initial Comments at p. 6.

[252]NY Com Initial Comments at p. 1 FLA-PAGE CITIATION ?6-18 (discussing FPL and Cajun).

[253]See also Southern.

order replacement rates.[254] The Commission's proposed procedure would unlawfully place the burden of justifying existing rates on the utilities.

Reply Comments

A number of commenters provide instances of discriminatory behavior they have faced over the years. NCMPA describes difficulties it has faced in dealing with CP&L, including a situation where CP&L allegedly impeded NCMPA's use of transmission access through CP&L's control of dispatching.[255]

AMP-Ohio alleges that Toledo Edison refused to transmit emergency power on a buy-sell basis to certain AMP-Ohio members even though Toledo Edison's system was not constrained. Instead, AMP-Ohio alleges, Toledo Edison bought the power and resold it to AMP-Ohio at a higher rate.

APPA challenges EEI's claim that there is no substantial evidence of undue discrimination in transmission. It suggests that nineteen instances of transmission disputes being filed since the Energy Policy Act was enacted is ample evidence of undue discrimination. Moreover, according to APPA, reported abuses are only the tip of the iceberg.

CCEM responds to the argument raised by EEI and others that there is no showing of extreme circumstances of

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[254]See also Southern.

[255]We note that CP&L raised legal objections to our authority to implement this rule.

discrimination in the electric industry such as the AGD court noted in the gas industry. It says that these circumstances are present and gives numerous examples; it does not identify the specific utilities because "it is the experience of * * * (our) members that nearly all transmission owners retaliate **[31,681]** * * *" against anyone who complains. Moreover, in answer to EEI's statement that transmission disputes are rare, CCEM states that since most of the competition is in the short-term market, it has not been worthwhile to file complaints. The examples provided by CCEM include: (1) refusal by a California public utility to offer firm service; (2) refusal by control area utilities in Texas to offer ancillary services to a power marketer, with the result that one of the utilities won the bid, even though it did not have the lowest price; (3) non-utilities in ERCOT being unable to compete to meet short-term requests for economy energy because they were required to schedule by noon of the preceding day, while utilities did not subject themselves to such a scheduling requirement; (4) power pool or control area information requirements, particularly in the northwest part of WSPP, that force non-utilities to reveal commercially sensitive information; the transportation operator has then revealed the information to its own or its affiliate's sales arm, which "steals" the deal; (5) a northeast power pool that refused to wheel out even though capacity was available on the grounds that sending power out of the pool would drive up prices in the pool (hoarding); (6) a power marketer that asked a utility to provide transmission, whereupon the utility bought up certain transmission capacity necessary for the marketer to reach its buyer, thus blocking the path -- this was possible because the utility was able to locate the purchaser based on commercially sensitive information the marketer had to give the utility when the marketer asked for transmission; (7) a common contracting

practice among utilities restricting the use of interconnections to themselves, particularly in the Southwest Power Pool, MAPP, and MAIN; (8) utilities overstating the cost of improvements (gold-plating) and thus discouraging service. CCEM also responds to each of EEI's criticisms of CCEM's examples of undue discrimination submitted in its February 16, 1995 petition and argues that its examples of undue discrimination are unrebutted.

Brownsville asserts that

while PUB [Brownsville] must pay multiple distance-based and pancaked transmission rates to engage in transactions with the non-ERCOT universe, El Paso Electric would have received transmission payments from its merger partners while gaining free transmission access to buy and sell within ERCOT. CSW presently walls other ERCOT utilities off from participation in the Western Systems Power Pool, while its ERCOT subsidiaries, CPL and WTU, share in the benefits of their non-ERCOT affiliates' WSPP memberships via the preferential terms of the CSW Operating Agreement. CSW treats its own inter-affiliate central dispatch as having a higher priority than third-party economy energy transactions, with the result that CPL not infrequently crowds PUB out of the economy market.[256]

Wisconsin Municipals states that its members have been fighting transmission battles for years and sets forth five examples of the sort of difficulties it has experienced in

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[256]Brownsville Reply Comments at p. 2-3 (emphasis in original).

attempting to obtain transmission rights. For example, it explains that Wisconsin public utilities have resisted an effort by the state commission to achieve comparability of use of transmission. Wisconsin Municipals also explains a situation where "if WPPI continued to purchase its power from WPSC, it would pay WPSC $843,840 annually for transmission service: if it purchases power off system from WP&L (one of WPSC's competitors), WPPI would pay WPSC $1,774,224 for transmission service to the exact same load."

TAPS sets forth additional examples of undue discrimination, including refusals to wheel even in the face of Nuclear Regulatory Commission (NRC) nuclear license conditions requiring wheeling, and Northeast Utilities' refusal to provide transmission to a QF even though it had indicated to the Commission that it would provide such transmission in order to obtain Commission approval of its proposed merger with Public Service Company of New Hampshire.

NIEP sets forth ten examples of undue discrimination that its members have experienced in seeking access to transmission service at reasonable terms and conditions.

[31,682]

Some commenters challenge these claims of undue discrimination. For example, Carolina P&L responds to NCMPA #1's example of obstruction by Duke in accommodating energy sales from the jointly owned Catawba Plant. Carolina P&L explains that NCMPA #1's proposal "would require Duke to provide its own generation resources on behalf of NCMPA #1 in order to support a bulk power sale when NCMPA #1's own resource capacity and energy are not sufficient for the sale." Carolina P&L argues that this is

backstanding that goes beyond the scope of any ancillary service the Commission has proposed and would be entirely inappropriate "to compel the Transmission Provider to sell power to its Transmission Customer for resale on the bulk power market."

Duke also responds to NCMPA #1's claim of discrimination and asserts that NCMPA #1's claim is not relevant to the NOPR proceeding, but is a specific contractual claim that should be pursued pursuant to the terms of its contract.

Commission Conclusion

We conclude that unduly discriminatory and anticompetitive practices exist today in the electric industry and, more importantly, that such practices will increase as competitive pressures continue to grow in the industry, unless the Commission acts now to prevent such practices.[257] It is in the economic self-interest of transmission monopolists, particularly those with high-cost generation assets, to deny transmission or to offer transmission on a basis that is inferior to that which they provide themselves. The inherent characteristics of monopolists make it inevitable that they will act in their own self-interest to the detriment of others by refusing transmission and/or providing inferior transmission to competitors in the bulk power markets to favor their own

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[257]While many public utilities have filed some form of open access tariff (often in response to our proposed rule), we believe that many of the remaining utilities will not voluntarily open their systems absent a final rule. See also note 266.

generation, and it is our duty to eradicate unduly discriminatory practices. As the AGD court stated: "Agencies do not need to conduct experiments in order to rely on the prediction that an unsupported stone will fall."[258]

We set forth examples in the NOPR of undue discrimination that we believe are occurring in the electric industry and invited commenters to identify any discrimination that they may have experienced. In response, commenters presented numerous additional examples of undue discrimination, which are summarized above, and we set forth below further examples of undue discrimination that have been raised in cases before the Commission.

Many of the examples of discriminatory behavior that have been brought to our attention do not name the specific utilities involved, and many are allegations that are not proven. However, we do not believe that this undermines our finding of unduly discriminatory practices by transmission owners and controllers. We believe that it is only natural that potential transmission customers with an interest in participating in electric markets will be reluctant to name names for fear of being shut out of those markets. CCEM, which identified a wide array of discriminatory behavior its members have experienced, explained that

(w)e do not identify the specific utilities in each example because it is the experience of CCEM members that nearly all transmission owners retaliate by cutting off all communications with anyone that challenges or complains

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[258]AGD, 824 F.2d at p. 1008.

about the rates, terms or conditions at which the owner offers access to its system. Inasmuch as most of the competitive commerce in electric power today is in short-term markets, it is typically not worth the effort of CCEM members or other transmission-dependent entities to file a complaint with the Commission's enforcement staff or in the courts in connection with a transmission owner's discriminatory practices. The deal is lost well before a complaint can be processed and ruled upon.[259]

Other examples of discriminatory behavior have also been raised in proceedings before the Commission. As we **[31,683]** explained in detail in the NOPR, transmission-owning utilities have discriminated against others seeking transmission access in a variety of ways, most often subtly and indirectly.[260] For example, delaying tactics have been used to frustrate access. The history of Pacific Gas and Electric Company's (PG&E) attempt to avoid its commitments made to the California owners of the California-Oregon Transmission Project (COTP) is a prime example. The owners had originally planned the COTP to have its southern terminus at the Midway station with Southern California Edison. PG&E convinced them to terminate the project instead at PG&E's Tesla station and indicated that PG&E would provide transmission service the rest of the way south to Midway. PG&E promised this service in 1989 (in Principles). PG&E spent the next four years filing substitute

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[259]CCEM Initial Comments at p. 18-19. See also NIEP Reply Comments at p. 13 n.31.

[260]*FERC Statutes and Regulations* at p. 33,072.

provisions for what it had promised in the Principles.[261] Additional allegations of discriminatory behavior are set forth in Appendix C, which includes allegations made under oath in proceedings at the Commission and allegations made in pleadings and other documents before the Commission.

In addition, to date, the Commission has received 28 section 211 transmission requests.[262] Applicants submit section 211 transmission requests when the transmission provider refuses to provide the requested transmission service. For example, American Municipal Power-Ohio, Inc. (AMP-Ohio) requested Ohio Edison Company (Ohio Edison) to establish additional delivery points to certain of AMP-Ohio's members and to permit the addition of delivery points in the future upon AMP-Ohio's request. Ohio Edison refused AMP-Ohio's request, claiming that it was not a proper request under section 211 because it already provided wholesale transmission to the municipal utilities at issue. In a proposed order, the Commission disagreed with Ohio Edison and ordered Ohio Edison to provide the requested additional

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[261] *See Pacific Gas and Electric Company*, 65 FERC ¶61,312 at p. 62,428-30 and n.22, remanded on other grounds, *Pacific Gas & Electric Company v. FERC*, No. 94-70037 (9th Cir. June 23, 1994)(unpublished opinion), order on remand, 69 FERC 61,006 (1994).

[262] A list of section 211 applications and the status of each is attached as Appendix A.

delivery points and to entertain future requests by AMP-Ohio for specific delivery points.[263]

Many of the examples of discriminatory actions we are seeing in the electric industry are similar to those we saw in the gas industry. Given our experience, we find that these examples of discriminatory actions are credible and well-founded. Thus, we conclude that there is more than sufficient reason to believe that transmission monopolists currently engage in unduly discriminatory practices, and that they will continue to engage in unduly discriminatory practices, unless we fashion a remedy to eliminate their ability and incentive to do so. In light of the competitive changes occurring in today's electric industry, we believe that the only effective remedy is non-discriminatory open access transmission, including functional unbundling and OASIS requirements, and that it is within our statutory authority to order that remedy.

Further, we disagree with the argument that we are limited to applying a traditional antitrust analysis in determining whether market power exists in the transmission system. While we must take antitrust concerns into consideration in exercising our responsibilities under the FPA, we are not an antitrust court, and our responsibilities are not those of the Department of Justice.[264] We have

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[263] *American Municipal Power-Ohio, Inc. v. Ohio Edison Company*, 74 FERC ¶61,086 (1996).

[264] *See, e.g., Gulf States Utilities Company v. FPC*, 411 U.S. 747, 758-60 (1973); *FPC v. Conway Corporation*, 426 U.S. 271, 279 (1976); *Northern Natural Gas Company v. FPC*, 399 F.2d 953, 960 (D.C. Cir. 1968).

analyzed the incentives and practices of monopoly transmission owners and controllers in light of the statutory standards and directives of the FPA and, based on our findings, have properly concluded that there is a generic problem that must be remedied.

The Commission also recognizes, as some commenters suggest, that we have, in the past, permitted utilities to file tariffs containing restrictions on transmission **[31,684]** service that we are now finding to be unduly discriminatory in this rule and that we found unduly discriminatory in cases since our decision in AEP. However, it is entirely appropriate, and indeed necessary, that our application of the FPA's undue discrimination standard evolve over time and adapt to the changing circumstances in the industry. Our prior willingness to tolerate the use of monopoly power over transmission to maintain and aggregate the utility's market power over generation occurred in the context of an industry structured largely as vertically integrated regulated monopolies that supplied all facets of utility service -- power supply, transmission, and distribution -- as a single monopoly service. Competition generally was not meaningfully available as a means to discipline prices and consumer interests were best served by improving efficiencies of the integrated utilities, subject to cost-based regulation.

Today, the circumstances of the industry are radically different. As explained in detail in Section III, a series of significant economic, regulatory, and technical changes in the power industry has introduced the promise of competitively priced power supplies. The profile of electric power suppliers has expanded to include not just the power supply arms of traditional utilities, but also independent power suppliers,

affiliated utility power suppliers selling into territories of other franchise utilities, and power marketers.[265] This offers the promise of an increasingly competitive commodity market in electric power, in which significant benefits to consumers can be achieved. In the context of an emerging competitive market in generation, discriminatory practices that once did not constitute undue discrimination must be reviewed to determine whether they are being used to prevent the benefits of competition in generation from being achieved. Here we find conclusively that they are, and use our remedial authority to ensure that they can no longer occur.[266]

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[265]We note that there are now 14 power marketers that are affiliated with public utilities.

[266]We take note of EEI's comments that, at the time of the comments, 30 utilities had filed open access tariffs. They argue, therefore, that the rule is unnecessary. Since their comment was filed, the number of utilities filing some form of an open access tariff has risen to 106. However, while some of these tariffs are based on the NOPR pro forma tariffs, many of these tariffs fall significantly short of the tariff requirements of both the NOPR and this Rule. Even if the tariffs met these requirements, the Rule is still needed to complete the task of eliminating undue discrimination by all public utilities and assuring, to the extent possible, a nationwide open access transmission grid. Indeed, a number of these tariffs were filed for the purposes of securing authority to market power competitively. This underscores markedly our fundamental conclusion that prior practices of using monopoly power over transmission to preserve market power over electricity sales has no place in today's industry and must be eliminated to get the benefits of competition to the customers we are required to protect under the FPA.

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[pp. 31,687 - 31,703]

[31,687]

C. *Comparability*

1. Eligibility to Receive Non-Discriminatory Open Access Transmission

In the NOPR, the Commission proposed to define who is eligible to receive service under a non-discriminatory open access tariff as follows:

A non-discriminatory open-access tariff must be available to any entity that can request transmission services under section 211.[281]

The Commission further explained that "[u]nder section 211, any electric utility, Federal power marketing agency, or any other person generating electric energy for sale tot resale may request transmission services under section 211."[282]

PSNM believes that the NOPR properly defined customer eligibility. NIEP, on the other hand. believes that the posed definition is too limited. It argues that the Commission should require public utilities to make transmission service available to all entities engaged in

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[281] *FERC Statutes and Regulations P* 32,514 at p. 33,083 (footnote omitted)

[282] *Id.* at p. 33,083 n.195.

wholesale purchases or sales of power, not just to those "generating" power. Utility Working Group requests that the Commission **[31,688]** clarify that eligibility is dependent not only on being the type of entity set forth in section 211, but on meeting the requirements of section 212(h) (Prohibition on Mandatory Retail Wheeling and Sham Wholesale Transactions) as well.[283]

We also received several comments related to the applicability of the rule to foreign entities. Canada states that the requirements for comparability and reciprocity should be implemented in a flexible masher to permit Canadian utilities to have fair and competitive access in the U.S. electricity market. Maritime requests that the Commission require Canadian utilities who wish to participate in the U.S. market to offer other utilities the same privileges they receive in the United States. Southwestern argues that transmission to a foreign country is in interstate commerce and that a utility should therefore accommodate this type of transmission request under its open access tariff. El Paso argues that the Commission does not have the authority to condition access to foreign countries, but states that if the Commission nevertheless exercises such authority it should do so on a case-by-case basis, Destec asserts that the posturing of Ontario Hydro before U.S. regulators pleading for open access and non-discriminatory transmission treatment – even for extra-territorial entities, should be met with a strong reply that such provisions should also be afforded transmission dependent entities on the Canadian side of the border. Ontario

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[283] Section 212(h) (Prohibition on Mandatory Retail Wheeling and Sham Wholesale Transactions).

Hydro's aggressive pursuit of U.S. market opportunities while simultaneously blocking competitors through the control of their transmission assets can not be ignored. Commission Conclusion.

In the Final Rule pro forms tariff the Commission has modified the definition of "eligible customer" to address concerns that in some respects the NOPR definition was too limited and in other respects it was too broad. This includes amended language to clarify that any entity engaged in wholesale purchases or sales of energy, not just those "generating" electric power, is eligible. It also includes clarification that entities that would violate section gig(h) of the FPA (prohibition on Commission-mandated wheeling directly to an ultimate consumer and sham wholesale transactions) are not eligible. The language also has been modified to provide that foreign entities that otherwise meet the eligibility criteria may obtain transmission services. Further, it has been modified to provide for service to retail customers in circumstances that do not violate FPA section 212(h).[284]

Persons that would be eligible section 211 applicants also would be eligible under the open access tariffs. Section 211 applicants may be any electric utility, Federal power marketing agency, or any other person generating electric energy for sale for resale.

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[284]We emphasize that any transmission customer must follow prudent utility practices so to assure reliability.

Section 3(22) of the FPA. as amended by the Energy Policy Act, defines "electric utility" co mean any person or State agency (including any municipality) which sells electric energy; such term includes the 'Tennessee Valley Authority. but does not include any Federal power marketing agency. Thus, as we have previously noted, municipal utilities are electric utilities simply by the terms of the statute.[285] In addition, we have also found that cooperatives and marketers are electric utilities as defined in the FPA.[286] Other entities that fall within the definition include IOUs, IPPs, APPS, and QFs that sell electric energy.

We do not believe that entities that engage solely in brokering should be eligible. Such brokers do not take title to electricity and therefore do not engage in the sale of electric energy; nor do they generate electric energy for sale for resale.[287]

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[285]New Reporting Requirement Implementing Section 213(b) of the Federal Power Act Supporting Expanded Regulatory Responsibility Under the Energy Policy Act of 1992, and conforming and Other Changes to Form No. FERC-714. Order No. 558-A, 65 FERC ¶61,324 at p. 62.451 n. 12 (1993).

[286]Order No. 558. *FERC Statutes and Regulations* ¶30,980 at p. 30,895-96, reh'g denied. 65 FERC ¶61,324 (1993) (cooperatives are electric utilities): *AES Power, Inc.*, 69 FERC ¶61,345 at p. 62.297 (1995) (power marketer is an electric utility, i.e., a person "which sels electric energy").

[287]*See, e.g., Citizens Energy Corporation*, 35 FERC ¶61,198 at p. 61.452-53 (1986).

[31,689]

Although such brokers are not eligible under the tariffs, they will be able to arrange deals because they will have access to the OASIS of all public utilities and will be able to solicit information from the relevant transmission service providers under the terms of the applicable tariffs.

We clarify that foreign entities that otherwise meet the eligibility criteria must be eligible to receive service under the non-discriminatory open access transmission tariffs.[288] We are making this determination pursuant to our authority under section 206 of the FPA to remedy undue discrimination. As we explained in the NOPR, market power through the control of transmission can be used discriminatorily to block competition. Customers in the United States should not be denied access to cheaper supplies of electric energy, whether such electric energy is from a domestic source or a foreign source. By making non-discriminatory access available to foreign entities that otherwise meet the eligibility criteria: we are assuring that customers in the United States have access to as many potential suppliers as possible. This should result in increased competition and lead to customers paying the lowest possible prices for their electric energy needs. To the extent that such an entity obtains access, however, we emphasize that it would be subject to all of the terms and conditions of the applicable open access tariff, including the requirement that it provide reciprocal service.

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[288]In making this determination, we are not deciding whether these entities are eligible entities under section 211(a) of the FPA.

Finally, we have reconsidered our NOPR position that would have limited eligibility to wholesale transmission customers. As we explained in the NOPR. the Commission's jurisdiction, extends to all unbundled transmission, in interstate commerce by public utilities. It is irrelevant to the Commission's jurisdiction whether the customer receiving the un-bundled transmission service in interstate commerce is a wholesale or retail customer. Thus, if a public utility voluntarily offers unbundled retail access interstate commerce or a state retail access program results in unbundled retail access in interstate commerce by a public utility, the affected retail customer must obtain its unbundled transmission service under a non-discriminatory transmission tariff on file with the Commission. Though the Commission may approve a separate retail transmission tariff when some variation is necessary or appropriate to meet local concerns,[289] we generally see no reason why retail transmission tariffs necessarily must be different from wholesale transmission tariffs. For that reason, we anticipate that in .many circumstances the same open access tariff that serves wholesale customers will be equally appropriate for retail transmission customers. Therefore, unless the Commission has specifically permitted a separate retail tariff, eligible customers under the Final Rule pro forma

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[289]See Section IV.I.

tariff must include unbundled retail customers,[290] We discuss this further in Section IV.I.

While the rates, terms, and conditions of all unbundled transmission service will be subject to a Commission-authorized tariff, we will, in appropriate circumstances, give deference to state recommendations regarding rates, terms, and conditions for retail transmission service or regarding the proper transmission cost allocation to be used between retail and wholesale customers when state recommendations are consistent with our open access policies. This is also discussed further in Section IV.I.

Moreover, we are mindful of the fact that we are precluded under section 212(h) from ordering or conditioning an order on a requirement to provide wheeling directly to an ultimate consumer or sham wholesale wheeling. We therefore clarify that our decision to eliminate the wholesale customer eligibility requirement does not constitute a requirement that a utility provide retail transmission service. Rather, we make clear that if a utility chooses, or a state lawfully requires, unbundled retail transmission service, **[31,690]** such service should occur under this tariff unless we specifically approve other terms.

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[290]The Commission has no authority to order retail transmission directly to an ultimate consumer or to order "sham" wholesale transmission, See FPA section 212(h). However. if such access occurs voluntarily or as a result of a state program, the rates, terms, and conditions of the access are within our exclusive jurisdiction if the service is provided by a public utility.

2. Service That Must be Provided by Transmission Provider

In the NOPR, the Commission proposed that a public utility must offer to provide any point-to-point or network transmission service whether or not the utility provides itself that service:

The Commission therefore proposes that all public utilities must offer both firm and non-firm point-to-point transmission service and firm network transmission service on a nondiscriminatory open access basis in accord with the proposed rule and the attached appendix tariffs. The Commission believes that a utility's tariff must offer in provide any point-to-point transmission service and network transmission service that customers need, even though the utility may not provide itself the specific service requested.[291]

EGA and SMUD agree that a transmission owner should offer any transmission service it is able to provide, even if it does not use the service itself:

Public Generating Pool, an association of consumer-owned electric utilities, appears concerned that the Commission may interpret comparability broadly to require a utility to offer the same service provided by another utility or to offer service generally available in a region. Thus, it recommends that a third party seeking more service than a utility provides itself be required to resort to the section 211 process.

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[291]FERC Statutes and Regulations ¶32,514 at p.33,079

Commission Conclusion

Initially, we note that, with the possible exception of small utilities (which may qualify for a waiver, see infra), we have seen no evidence that public utilities are incapable of reasonably providing the services required in the Final Rule pro forma tariff. Nor have we seen evidence that utilities able to provide these services to themselves are choosing to forego such services. In short, we are not convinced that there is an appreciable difference, if any, among the services required in the pro forma tariff, the services utilities are able to provide, and the services they actually provide themselves.

To the extent these services do differ, however, we explicitly adopt the proposal set forth in the NOPR. Thus, a public utility must offer transmission services that it is reasonably capable of providing, not just those services that it is currently providing to itself or others. Because a public utility that is reasonably capable of providing transmission services may provide itself such services at any time it finds those services desirable, it is irrelevant that it may not be using or providing that service today. Moreover. a public utility must offer these transmission services whether or not other utilities may be able to offer the same services and whether or not such services are generally available in the region (waiver of these requirements for .small utilities is discussed in Section IV.K.2.).[292] However, if a customer seeks a customized service not offered in an open access

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[292]Requirements for ancillary services are discussed in Section IV.D.

tariff, a customer may. barring successful negotiation for such service, file a section 211 application.

3. Who Must Provide Non-Discriminatory Open Access Transmission

In the NOPR, the Commission proposed to require all "public utilities" owning and/or controlling facilities used for transmitting electric energy in interstate commerce to file open access transmission tariffs.[293] We explained that we could not require all "transmitting utilities" to file open access tariffs under sections 205 and 206 because we do not have jurisdiction over non-public utilities under these sections.

Several commenters argue that the open access requirement must be applied to non-jurisdictional utilities that own interstate transmission facilities.[294] Power Marketing Association recognizes that this raises difficult legal issues and suggests that the Commission support legislation to expand the Commission's authority over non-jurisdictional utilities. Minnesota P&L argues that ir the requirement is not applied to all entities that own transmission, jurisdictional and **[31,691]** non-jurisdictional entities owning joint transmission facilities will be competitively disadvantaged due to unequal pricing. Union Electric argues that unless the requirement is extended to the 56 non-jurisdictional entities operating control areas, discrimination in the wholesale power markets will increase.

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[293] *FERC Statutes and Regulations* ¶32,514 at p. 33,049.

[294] *E.g.*, Minnesota P&L, Power Marketing Association.

A number of municipal commenters assert that the NOPR overlooks transmission assets jointly owned by jurisdictional and non-jurisdictional utilities.[295] They argue that agreements regarding use of these assets often contain provisions prohibiting third-party power transfers. They further argue that such provisions should be nullified, and the joint owners should be required to develop equitable methodologies to allocate wheeling revenues among themselves.

Several cooperatives urge the Commission to clarify that contracts among their constituent cooperatives are not subject to any unbundling of existing contracts.

Commission Conclusion

Our authority under sections 205 and 206 of the FPA permits us to require only public utilities to file open access tariffs as a remedy for. undue discrimination. We have no authority under those sections of the FPA to require non-public utilities to file tariffs with the Commission.

However, we are concerned that if nonpublic utilities do not provide access, there will remain a patchwork of "open" and "closed" transmission systems and the potential for distortions in wholesale bulk power markets. We believe that certain mechanisms exist that will help to alleviate these problems.

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[295]E.g., Springfield.

First, as we explained in the NOPR, broad application of section 211 will provide wider access to bulk power markets.[296] Under section 211, eligible entities may seek transmission service from "transmitting utilities," which section 3(23) of the FPA defines as "any electric utility, qualifying cogeneration facility, qualifying small power production facility, or Federal power marketing agency which owns or operates electric power transmission facilities which are used for the sale of electric energy at wholesale." We believe that section 211 provides us with authority to require the same quality of transmission service as sections 205 and 206, though the procedural path is more cumbersome. Thus, section 211 provides access to transmission systems owned or operated by non-public utilities.[297]

Second, as we explained in the NOPR, our reciprocity requirement is designed to provide the widest possible use of the nationwide transmission grid:

The purpose of this provision is to ensure that a public utility offering transmission access to others can obtain similar service from its transmission customers. It is important that public utilities that are required to have on file tariffs be able to obtain service from transmitting utilities that are not public

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[296] *FERC Statutes and Regulations* ¶32,514 at p. 33,050 and 33,092-93.

[297] As discussed in the NOPR, sections 211 and 212 require that applicants specify only fates, terms, and conditions of service, not specify transactions. Thus, applicants can file requests for tariffs to accommodate future currently unspecified transactions, similar to the open access tariffs required by this Rule.

utilities, such as municipal power authorities or the federal power marketing administrations that receive transmission service under a public utility's tariff.[298]

Finally, again as we explained in the NOPR, the formation of RTGs should speed the development of competitive markets and involve more non-public utilities in the provision of non-discriminatory open access transmission.[299] In approving RTGs, our policy has been to require all members, whether or not they are public utilities, to offer comparable transmission services at least to other members.

We recognize that these solutions are not perfect. However, given the difficulties inherent in the statutory scheme, we believe they will go a long way toward effectuating transmission access by nonpublic utilities,

One further issue involving non-public utilities concerns jointly owned transmission facilities. We will not allow public utilities that jointly own interstate transmission **[31,692]** facilities with non-jurisdictional entities to escape the requirements of open access. We will require each public utility that owns interstate transmission facilities jointly with a non-jurisdictional entity to offer service over its share of the joint facilities, even if the joint ownership contract prohibits service to third parties. we urge such public utilities to seek mutually agreeable revisions to their agreements to permit

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[298] *FERC Statutes and Regulations* ¶32,514 at p. 33,089.

[299] *Id.* at p. 33,095.

third-party access over all. or at least their share, of the facilities. For those joint ownership arrangements that include restrictions on the usage of jointly owned transmission facilities by third parties, we will require the public utilities, in a section 206 compliance filing. to file with the Commission, by December 31, 1996, a proposed revision (mutually agreeable or unilateral) to its contract with the non-jurisdictional owner(s). This revision must be designed at a minimum to permit third parties to use the public utility's share of the joint facilities in accordance with this Rule and must provide for any needed cost allocation procedures between the public utility and the non-jurisdictional owner(s).

4. Reservation of Transmission Capacity by Transmission Customers

In the NOPR, the Commission set forth the information that a requester of transmission service would have to submit with a service request. We recognized that there may have to be a limit, for competitive reasons, on the information required, but also recognized the need to assure that no customer would reserve scarce capacity and then hold it without using it.[300] To avoid forcing transmission customers to reveal unnecessary details of their purchase or sales transactions, the Commission discussed several less restrictive options: (1) Allow the transmission provider to use or sell the capacity while it is unused, (2) have a pool that clears the short-term market, and (3) require the customer to begin using the capacity within some specified period or lose its

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[300] *Id.* at p. 33,090.

reservation rights. The Commission requested comments on these and other possible approaches.

Unused or Unneeded Transmission Capacity

Many commenters recommend a use-it-or-lose-it rule (i.e., a transmission customer must use its reserved transmission capacity or lose its rights to that capacity).[301] Several commenters also recommend a number of restrictions on capacity reservations to reduce incentives to hoard or to cherry-pick (request to reserve firm capacity only during peak hours of peak seasons) existing transmission capacity. These include: (I) Allow requesters to reserve a place in the queue with a right o[first refusal over later competing requests; (2) impost a take-or-pay charge on reservations and deny reservation holders the right to revenue sharing if they do not schedule or assign their rights; (3) limit the time period for reservations; (4) limit how far in advance reservations may be made for both non-firm and firm services: (5) maintain a price cap on the resale of transmission; (6) require multi-year reservations to be for sequential periods; and (7) require a nonrefundable fee for advance reservations of service.[302] Southwestern suggests that transmission tariffs include a provision that prevents transmission customers and the

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[301] *E.g.*, Consumers Power, Northern States Power, PacifiCorp, Oklahnma G&E, Allegheny Power, ELCON, Public Service Co of CO.

[302] *E.g.*, Northern States Power, VEPCO, Utilities For Improved Transition, PacifiCorp, Arizona Public Service, Dairyland, Montaup, Illinois Power, South Carolina E&G, Florida Power Corp. KU.

transmission provider from reserving and tying up firm transmission capacity for speculative wholesale actions.[303]

On the other hand, PSNM believes that a use-it-or-lose-it approach is inappropriate because any prudent utility that has reserved capacity would seek to sell the service it is not using so as to recover some portion of its fixed costs. Wisconsin P&L argues that a use-it-or-lose-it approach would not work, would be difficult to administer, and may be anticompetitive.[304] Central Illinois Public Service asserts that a reservation holder has little incentive to hoard capacity because other customers can use the capacity on a non-firm basis during times when a reservation **[31,693]** holder does not schedule power. It warns that giving the transmission operator the ability to schedule unused capacity may result in undue influence and the exercise of market power. CA Energy Cpm maintains that, while reassignment would help prevent hoarding, it would not assure efficient use of the full transmission network,

Use of Pooling Arrangements To Prevent Improper Reservations

Allegheny Power contends that a pooling arrangement could provide an incentive to hoarders to release capacity during a shortage. It suggests that capacity could be auctioned within a pool pt available capacity. However, it acknowledges

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[303]See also NRECA.

[304]Wisconsin P&L notes, however, that a possible exception exists where a user could block the efficient transfer of power and then market its own power at a premium price.

that an auction would be tantamount to allowing the network owner to sell transmission service at unregulated rates.

PacifiCorp does not believe that a pooling arrangement would prevent capacity hoarding unless nonsequential reservations are prohibited ELCON contends that a use-it-or-lose-it rule would be fairer and more effective than pooling.

Commission Conclusion

Upon further consideration, we conclude that firm transmission customers, including network customers, should not lose their rights to firm capacity simply because they do not use that capacity for certain periods of time. Firm transmission customers that have reserved capacity and paid a reservation charge generally do not use the entire amount of reserved capacity at all times. This does not mean, however, that they must permanently return the unused amount to the utility. In the absence of evidence of hoarding or other anticompetitive practices, we will not limit the amount of transmission capacity that a customer may reserve. Firm transmission customers are in the best position to know the levels of electric energy they will be transmitting and the level of flexibility they need in carrying out their transmission activities. Indeed, when they are not using their reserved capacity, firm transmission customers remain obligated to pay the utility a reservation charge that covers all of the utility's fixed costs associated with the reserved capacity.[305]

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[305]A reservation charge would assure that the utility fully recovers its fixed costs associated with the transmission customer's reserved transmission capacity.

Moreover, the possibility that a customer will reserve capacity and then hold it without using or reassigning it is mitigated because the utility is free to schedule and sell any unscheduled firm point-to-point transmission capacity on a non-firm basis to any entity eligible to receive such service under the utility's tariff. We also note that it is in the economic self interest of reservation holders to make available unused capacity to the market.[306]

We recognize that situations could arise in which a customer unlawfully withholds capacity. That is, a transmission customer could retain capacity in a way that could have an anticompetitive effect. For example, a transmission customer may serve certain capacity simply to prevent everyone else From using it and to make its own generation the only alternative available to the market. However. as described above, we believe that the incentives are such that parties are more likely to release unneeded capacity and that a generic remedy is therefore unnecessary. Any substantial allegations that indicate that a transmission customer is withholding scarce capacity in a way that has an anticompetitive effect would be addressed under section 206. If we round such allegations to be true, we could order the customer to return the capacity reservation right to the transmission operator. This approach should allay concerns that a customer may reserve scarce capacity and nat use it, without forcing customers to demonstrate need or to reveal details of individual transactions.

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[306]See Section IV.C.6.

5. Reservation of Transmission Capacity for Future Use by Utility Comments

EEI and many IOUs argue that native load and network transmission customers should have first priority to existing capacity for their reasonably forecasted load requirements because that capacity was constructed to provide service to them and was paid for by them.[307] EEI contends that such priority ensures **[31,694]** equity and comparability based on past and future cost responsibility for the system. Similarly, Florida Power Corp and PECO contend that third-party customers should not be allowed to use transmission capacity that native load customers would grow into within a reasonable planning horizon.

Other commenters disagree, asserting that available transmission capacity must be determined in the same manner for all customers and that utilities should not be permitted to reserve capacity for their own uses.[308] NIEP argues that utilities should not be permitted to lock up available transmission capacity over valuable transmission paths and then require transmission requesters to pay for the cost of incremental transmission upgrades. This would let the utility avoid incremental transmission charges on its system.

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[307] *E.g.*, NYPP, Public Service E&G, Sierra Pacific Power, Ohio Edison, Sierra Pacific Power asserts that a utility should be permitted to retain capacity for native load use over the pertinent planning period. El Paso adds that the Commission should allow utilities the opportunity to reserve capacity for anticipated uses that, although not firm, are necessary to maintain reliability.

[308] *E.g.*, NIEP, CCEM, Conservation Law Foundation.

Oklahoma G&E argues that existing available transmission capacity should be made available until it is needed for native load growth. Utilicorp states that transmission owners should not be permitted to set aside capacity for sales or purchases of economy energy. CCEM argues that the centerpiece of comparability is that ail transmission customers, including the merchant operations of the transmission owner, take service from available capacity pursuant to the same tariffs. CCEM .adds that allowing utilities to reserve capacity based on forecasted retail and network loads creates an incentive for them to over-forecast their load to the detriment of all others. NRECA suggests that the need to maintain reliability should not perpetuate transmission providers' preferential treatment of their own transactions. It also recommends that, during periods when facilities are constrained, access be allocated based on a combination of past actual use and planned future use.

Commission Conclusion

We conclude that public utilities may reserve existing transmission capacity needed for native load growth and network transmission customer load growth reasonably forecasted within the utility's current planning horizon. However, any capacity that a public utility reserves for future growth, but is not currently needed, must be posted on the OASIS and made available to others through the capacity reassignment requirements, until such time as it is actually needed and used.

In response to arguments raised by several commenters that existing requirements customers should have future right to existing capacity beyond the terms of their contracts

because of their historical use, as discussed previously, we believe existing customers should have a right of first refusal to capacity they previously used. if they are willing to match the rate offered by another potential customer, up to the transmission provider's maximum filed transmission rate at that time, and to accept a contract term at least as long as that offered by another potential customer.[309]

6. Capacity Reassignment

In the NOPR, the Commission proposed that a tariff must explicitly permit reassignment of firm service entitlements.[310] We explained thai reassignment of capacity rights could have a number of benefits: (1) Helping transmission users manage financial risk. (2) reducing transmission providers' market power by enabling transmission customers to compete with them, and (3) improving capacity allocation when capacity is constrained and some market participants value capacity more than current capacity holders. We requested comments on whether the current price cap on resale should be modified or eliminated and whether the transmission services described in the NOPR are suitable for reassignment.

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[309]See Section IV.A.5.

[310]*FERC Statutes and Regulations* ¶32,514 at p. 33,088.

General

Many commenters favor capacity reassignment and the development of secondary markets.[311] However, WP&L notes that reassignments should not be permitted over constrained interfaces if the **[31,695]** source or destination of power changes, and LA DWP opposes unrestricted reassignment because it could cause tax-exempt financing problems for many public power utilities.

Many IOUs argue that the same terms and conditions of service applied to IOUs should be applied to resellers of transmission services?[312] Arizona Public Service. however, asserts that all unused transmission rights should not be assignable, but should be made available to others in a manner consistent with the contract supporting the rights, it argues that a network user experiencing an off-system network shutdown should be required during the outage to make available to others the path from the point that the power enters the system to its load. It also contends that firm transmission customers should be required to post their unused rights on an EBB or RIN.

Several commenters oppose mandatory reassignment of firm capacity rights.[313] NEPCO declares that if a customer

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[311]*E.g.*, PacifiCorp, DOJ, NIEP, ELCON. United Illuminating, DOD, WP&L, FTC, OK Com and FL Com favor reassignment of capacity that reliability not be affected.

[312]*E.g.*, Northern States Power.

[313]*E.g.*, NEPCO, Nebraska Public Power District.

is willing to pay for its reserved capacity, it should not be forced to reassign unused capacity. Nebraska Public Power District believes that mandatory reassignment could cause problems for publicly-owned utilities. It further asserts that in the gas industry the Commission did not allow the unregulated reassignment regime it proposes for the electric industry.

SoCal Edison argues that when a transmission customer resells transmission capacity, it should not be released from its contractual obligation to the transmission provider. It notes that under traditional contract law, a party to a contract cannot escape its obligations by delegating them to another.

Price Caps

Most commenters addressing this issue support retaining the existing price capon reassignments or resales.[314] Generally, these commenters believe that the price cap is necessary to prevent customers from speculating or hoarding capacity in anticipation of its value increasing. Public Service Co of CO believes that allowing assignments of capacity at prices greater than cost could prevent a transmission provider from offering firm capacity for legitimate long-term transactions. TDU Systems states that a cap should remain

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[314] *E.g.*, NRECA, Montana Power, PacifiCorp. NYSEG, PA Corn, Idaho. Public Service Co of CO, FPC, Entergny, TDU Systems, Duke, Cajun, CVPSC, Oglethorpe, Minnesota DPS. FL Com argues that the price of reassignment should be capped at the contract selling price. WP&L argues that the price cap should be raised to the maximum rate allowed in the tariff under which the user purchased the original service.

until the secondary market in the relevant geographic market has been shown to be competitive. PA Corn states that turning available capacity into a spot market would tie up capacity that might otherwise be used on a day-to-day basis and for emergencies. Still other commenters argue that customers should not be allowed to sell the capacity for more than the transmitting utility could charge.[315] Allegheny argues that any rule that allows resale of transmission capacity at a higher price than the transmission provider can achieve is "patently illogical and probably illegal." Several utilities, including Allegheny and CSW. contend that if resellers can market transmission services at market rates, then transmission owners must be given the same opportunity.

Duquesne and United Illuminating argue that the price cap should be modified so that third parties are allowed to resell capacity at the higher of embedded costs or opportunity costs.[316] Duquesne notes that such a provision would be comparable to the option transmitting utilities now have and would be economically effi-dent because it would encourage the firm capacity owner with the lowest opportunity cost to resell its capacity.

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A few commenters argue that the price cap should be eliminated.[317] IL Corn claims that capacity will be made available to the entity that values it most and that an uncapped

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[315]See also Minnesota DPS.

[316]See also Midwest Commission, SMUD, CCEM.

[317]*E.g.*, IL Com, NEPCO, Consumers, American Wind.

resale market cannot lead to more market power because an efficient secondary market cannot be monopolized. Con Ed agrees that if the secondary market is competitive, all entities should be allowed to sell at market-based rates.[318] CT DPUC argues that there should not be a price cap: instead, it would prefer that those holding transmission rights not be allowed to withhold use of any portion of their reserved transmission capacity in the actual moment-by-moment operation of the grid.

Creditworthiness Standards

Of those commenting on the appropriate creditworthiness standards for replacement customers (assignees), all favor allowing the transmission provider to use reasonable credit procedures to assure that the replacement customer is financially sound.[319] NYSEG suggests that. at a minimum, the same creditworthiness criteria should be applied to the replacement customer as are applied to the original customer. Oglethorpe recommends that the assignee be required to commit to comply with all customer obligations and to pay for any additional costs resulting from the assignment.

Liability for Payment

Commenters split on whether the original customer or the replacement customer should be liable to the transmitting

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[318]If the market is not competitive, however, Con Ed maintains that the cap should be retained for all entities.

[319]*E.g.*, PacifiCorp, NYSEG, Oglethorpe.

utility for payment for the service. One group of commenters believes that the original customer should remain liable for all costs and for the performance of all obligations.[320] Another group of commenters believes that the original customer should be relieved of financial responsibility, at least under certain circumstances.[321] For example. NYSEG asserts that the original customer should be relieved of its obligations upon the execution of a new service agreement between the new customer and the provider. TDU Systems contends that the original customer should be relieved of future liability where the replacement customer meets the transmission provider's creditworthiness standards. Entergy argues that the original customer should, remain liable until all obligations are fulfilled.

Commission Conclusion

After reviewing the comments, we conclude that a. public utility's tariff must explicitly permit the voluntary reassignment of all or part of a holder's firm transmission

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[320]*E.g.*, Oglethorpe, NSP.

[321]*E.g.*, NYSEG, Entergy, TDU Systems, Trulock, American Wind.

capacity rights[322] to any eligible customer.[323] Reassignment may be on a temporary or permanent basis, and must be subject to the condition and requirements discussed below.

Allowing holders of firm transmission capacity rights to reassign capacity will: (1) Help them manage the financial risks associated with their long-term transmission commitments, (2) reduce the market power of transmission providers by enabling customers to compete, and (3) foster efficient capacity allocation. We offer below a number of clarifications and further explanations in response to concerns raised by commenters.

(1) Reassignable Transmission Services

We conclude that point-to-point transmission service, because it sets forth clearly defined capacity rights, should be reassignable. As for network transmission service, we conclude that there are no specific capacity rights associated with such service, and thus. network transmission service is not reassignable.

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[322]The transmission provider has the same rights as any other potential assignee to obtain capacity that is posted on an OASIS or to negotiate with the assignor for any capacity the assignor seeks to assign.

[323]The public utility's tariff shall not preclude an assignor from including a right of recall in its agreement with an assignee.

(2) Terms and Conditions of Reassignments

a. General

In effecting a reassignment, the assignor does not have to return its capacity entitlement to the original transmission **[31,697]** provider, but may deal directly with an assignee without involvement of the transmission provider. However, an assignee must meet the eligibility standard established by this Rule and must comply with the reliability criteria of the original transmission provider. Any such transaction must be posted on the transmission provider's OASIS within a reasonable time after its effective date. Alternatively, the assignor may, if it wishes, request the transmission provider to effect a reassignment on its behalf.[324] In such a situation, the transmission provider must immediately post the available capacity on its OASIS. The transmission provider must assure that any revenues associated with the reassignment are credited to the assignor.[325]

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[324]The assignor may also request the transmission provider to provide the billing and payment services for the reassignment. The parties would negotiate terms for such an arrangement, including a fee for the transmission provider. If an assignor is a public utility, it will have to have on file with the Commission a rate schedule governing reassigned capacity.

[325]Any expenses that the public utility incurs in carrying out the capacity assignment program would simply be included in its cost of service.

b. Contractual Obligations

Assignors and assignees may contract directly with each other, but the assignor will remain obligated to the transmission provider, This obligation extends to any penalties or other charges incurred by the assignee in its use of the reassigned capacity, The assignee will be liable solely to the assignor, and should it not meet its obligations, the assignor may cancel the assignment under their contract.

If the transmission provider and the original customer mutually agree, we will permit alternatives to the above approach. For example, the transmission provider could agree to relieve the original customer of payment liability for the term of the reassignment and permit the assignee to pay the provider directly.

In the case of a permanent reassignment. the transmission provider should not unreasonably refuse to release the assignor from liability if the assignee meets the transmission provider's creditworthiness requirements as set forth in its tariff and agrees to pay the price the assignor is obligated to pay the transmission provider.

c. Price Cap

We conclude that the rate for any capacity reassignment must be capped by the highest of: (1) The original transmission rate charged to the purchaser signor), (2) the transmission provider's maximum stated firm transmission rate in effect at the time of the reassignment, or (3) the assignor's own opportunity costs capped at the cost of expansion (Price Cap). We remain convinced that we cannot

lift the Price Cap and permit reassignments at market-based rates. Based upon the information available in this proceeding, we are unable to determine that the market for reassigned capacity is sufficiently competitive so that assignors will not be able to exert market power. Thus, we will not permit an assignor to reassign capacity at a rate in excess of the Price Cap. Assignees must agree, in contracting with the assignor, that the firm transmission capacity they will use is subject to the Price Cap.

7. Information Provided to Transmission Customers Comments

Many commenters argue that in an open access, competitive environment, confidential and proprietary information should not be made publicly available through a RIN.[326]

Several utilities assert that the existing reporting requirements are sufficient to support the comparability requirements of the proposed rule, with some modifications.[327] They note that the Commission's audit authority and complaint process will help enforce comparability requirements.[328] Central Illinois Public Service

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[326]Similar arguments with respect to the information that public utility must provide to the Commission in standard reports (*e.g.*, Form No. 1) are addressed later in this Final Rule.

[327]*E.g.*, PacifiCorp, NYSEG, NSP.

[328]See also PA Com.

states that, with the availability of pricing and transaction information through the RIN, no further reporting requirements are necessary. IL Com states that additional reporting should be required only if clear evidence emerges of discriminatory use of the transmission system. Dominion Resources adds that users have **[31,698]** no need for utility planning information and data on generator status and that disclosure of such information would place owners at a competitive disadvantage. VEPCO opposes the disclosure of any commercially sensitive information to marketers, including the utility's power marketing employees.

On the other hand, several commenters argue that the information submitted by public utilities may not be adequate. For example, APPA argues that the Commission should scrutinize closely cost functionalization by utilities to assure that plant in service is properly booked. Others recommend that the Commission put in place a monthly pass-through of transmission-related operating income for all classes of customers receiving firm transmission service, rather than rely on the current practice of reducing test year cost of service by revenues booked to Accounts 456 and 447. Industrial Energy Applications recommends that utilities be required to file quarterly reports with the Commission that detail the transmission services and the pricing of their off-system power supply transactions, as an incentive to comply with the Commission's rule. Commission Conclusion

We conclude that all necessary transmission information, as detailed in the OASIS final rule, must be posted on an OASIS. With respect to generation information, we will require, consistent with the OASIS final rule, that information needed to verify opportunity/redispatch costs be

provided, on request, to the transmission customer charged, We will not require this information, or any other generation information,[329] to be posted on an OASIS.[330]

[31,698]

8. Consequences of Functional Unbundling

a. Distribution Function

The NOPR proposed functional unbundling of wholesale generation and wholesale transmission so that the public utility as a wholesale seller could not gain an undue advantage from its transmission ownership. We did not propose to further unbundle the retail transmission and distribution functions from the wholesale transmission function.

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[329]The prices of some ancillary services, which are posted on the OASIS, are based on generation tusks, however.

[330]Because the Commission establishes many generation and all transmission rates on a cost basis, the Commission also will continue to sell the information that it collects in Form No. 1 and other standard forms from public utilities to assure that the rates arc just and reasonable. As we explain later in this Final Rule. the information provided in those forms is public information that is available to any transmission customer. However, because of the competitive changes occurring in the electric industry, we recognize that there may be a need to reexamine the information we collect from public utilities through the Form No. 1.

Comments

A number of commenters assert that utilities should be required to unbundle -- either functionally or corporately -- the distribution function from the transmission function. ELCON argues that unbundling distribution would help delineate state and Federal jurisdiction, facilitate the establishment of transmission pricing, avoid cross-subsidization, and prepare for the customer choice (retail wheeling) programs that will be implemented by states in the future. It contends that functional distinctions between wholesale and retail service should be minimized.[331]

Other commenters, however, oppose establishing a separate distribution function. DOD asserts that the Commission can address any problems that arise by enforcing the terms of open access tariffs and that the Commission should not intrude into state ratemaking.[332]

Various state commissions question the workability and desirability of a functional test to determine the dividing line between retail transmission and local distribution.[333] CA Com recommends that, to avoid jurisdictional uncertainty surrounding functional unbundling, the Commission adopt a functional test for local distribution. Under this test, vertically

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[331]See also Environmental Action, Missouri Basin MPA, Texaco, EGA, AEC & SMEPA.

[332]See also TDU Systems, Public Service Co. of CO.

[333]*E.g.*, NARUC, AZ Com, CT DPUC, OK Com, FL Com, NC Com, NM Com.

integrated utilities that chose to unbundle **[31,699]** into separate operating companies, including a local distribution company that sells only at retail, could establish a workable bright line between state and federal authority without engaging in the arduous task of differentiating transmission from distribution.

Certain IOUs echo the jurisdictional concerns raised by the state commissions.[334] They believe that the unbundling of the distribution function would create significant jurisdictional problems. Pacificorp also argues that unbundling of the distribution function would create significant jurisdictional conflict with respect to cost allocation.

Commission Conclusion

We conclude that the additional step of functionally unbundling the distribution function from the transmission function is not necessary at this time to ensure non-discriminatory open access transmission. Our approach to assuring such open access has two broad requirements: (1) functional unbundling of transmission and generation (which includes separately stated rates for generation, transmission, and ancillary services, and a requirement that a transmission provider take service under its own tariff), except for bundled retail service and (2) an OASIS with standards of conduct. We believe that additional requirements are not needed now. We further address in Section IV.I the concerns raised regarding

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[334] *E.g.*, Com Ed, Citizens Utilities, PacifiCorp.

our proposed tests to distinguish transmission and local distribution.

b. Retail Transmission Service

The majority of commenters addressing this issue believe that unbundling retail service is unnecessary to establish a competitive market and to achieve non-discriminatory open access transmission.[335] For example, PSNM argues that the Commission is not as well situated as are state regulators to oversee and supervise local reliability issues for retail customers. Central Illinois Public Service argues that due to the nature of transmission facilities and operations, it is not possible for the transmission provider to discriminate between the provision of wholesale and retail firm service. Several IOUs further contend that because the Commission is specifically precluded from mandating retail wheeling and has no authority over bundled retail service, the Commission cannot require retail service to be provided.[336]

In contrast, some commenters argue that functional unbundling must apply to all transmission service in interstate commerce provided by public utilities, including the transmission component of bundled retail sales.[337] They believe that this is necessary to achieve comparability. For

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[335]*E.g.* Allegheny Power, PacifiCorp, MidAmerican, PECO, Public Service Co of CO, Com Ed, NARUC, NRRI, MN DPS, ND Com, FL Com.

[336]*E.g.*, Allegheny Power.

[337]*E.g.*, CCEM, ABATE.

example, CCEM asserts that if the distribution function is not unbundled, the result will be service under two separate arrangements -- an explicit wholesale transmission tariff filed at the Commission and an implicit retail transmission tariff governed by a state regulatory body. According to CCEM, failure to unbundle retail transmission will allow transmitting utilities to manipulate how they characterize and account for their own uses of transmission. ABATE contends that the Commission, for efficiency reasons, should encourage states to permit retail access. It asserts that the Commission must adopt a policy that signals to states how rates, terms, and conditions of retail service will be established; once a state sets such parameters, the Commission should review them.

Commission Conclusion

Although the unbundling of retail transmission and generation, as well as wholesale transmission and generation, would be helpful in achieving comparability, we do not believe it is necessary. In addition, it raises numerous difficult jurisdictional issues that we believe are more appropriately considered when the Commission reviews unbundled retail transmission tariffs that may come before us in the context of a state retail wheeling program. The Commission therefore reaffirms its decision to require the unbundling **[31,700]** only of wholesale transmission from generation.[338]

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[338]But see discussion of buy/sell transactions in Section IV.I.

c. Transmission Provider

1. Taking Service Under the Tariff

In the NOPR, we explained that a public utility must take transmission services for all of its new wholesale sales and purchases of energy under the same tariff of general applicability under which others take service.[339]

A number of commenters argue that utilities should be required to take all of the transmission for their own use under their tariff.[340] CCEM asserts that a transmission owner should have to schedule, at arm's length, its retail transmission uses and pay posted rates into a separate account; otherwise the capacity might be overforecast at no cost.

PECO requests that the Commission clarify that the requirement that a transmission provider take service under its own transmission tariffs does not apply to: (1) retail service, (2) existing wholesale contracts, and (3) pooling arrangements. UNITIL claims that the requirement for a transmission provider to take service under its own tariff and to post its own tariff rate should not apply to pool transactions where a single pool-wide rate is applied.

A number of IOUs contend that it is not necessary for the transmission provider to take service under the network

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[339]*FERC Statutes and Regulations* ¶32,514 at p. 33,080.

[340]*E.g.*, Michigan Systems, Cleveland, Municipal Energy Agency Nebraska, Missouri Basin MPA, TAPS, Wisconsin Municipals, LG&E, NIEP, CCEM.

tariff because both the transmission provider and the network customers cannot use the tariff to make off-system sales. LILCO states that it is appropriate to distinguish between a transmission owner's use of its transmission system to make: (1) wholesale bulk power sales; and (2) off-system purchases to serve its native load retail customers. LILCO contends that in the second situation it should not be required to take transmission service under its own open access tariffs.

EGA argues that transmission owners should be required to take transmission service under open access tariffs for both wholesale off-system sales and purchases. It maintains that, as retail competition increases, utilities will eventually have to take retail service under their own tariffs. Power Marketing Association believes that comparability can be achieved only if transmission service provided in connection with coordination transactions is unbundled and the transmission provider takes such transmission service under its tariff.

Consumers Power also claims that there is an inconsistency between the NOPR text, the tariffs, and the proposed regulatory language regarding whether the requirement for a utility to take service under its own tariff applies only to new wholesale transactions. Commission Conclusion

We conclude that public utilities must take all transmission services for wholesale sales under new requirements contracts and new coordination contracts under

the same tariff used by others (eligible customers).[341] For sales and purchases under existing bilateral economy energy coordination agreements, we will give an extension until December 31, 1996, for public utilities to take transmission service under the same tariff used by others.[342] As further discussed in Section IV.F., we will also give an extension of time to December 31, 1996, for certain existing power pooling and other multi-lateral coordination agreements to comply with this requirement. This will ensure that utilities live by their own rules for wholesale transactions and that we can achieve non-discriminatory open access transmission. In the case of a public utility buying or selling at wholesale, the **[31,701]** public utility must take service under the same tariff under which other wholesale sellers and buyers take service.

2. Accounting Treatment

In the NOPR, we did not address any accounting aspects of our proposed rule.

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[341]With the exception of certain contracts and agreements executed on or before 60 days after publication of the Final Rule in the Federal Register, the regulation we are adopting requires that public utilities take service under their open access tariff for wholesale sales or purchases of electric energy and unbundled retail sales of electric energy, effective on the date the public utility engages in such transactions.

[342]As discussed in Section IV.F., the Commission will not impose this requirement on existing bilateral non-economy coordination agreements, but persons may file complaints that such agreements need to be modified.

IOUs generally object to a requirement that they pay themselves for their use of the transmission system.[343] NEPCO claims that it is a general principle of accounting that an enterprise cannot recognize and record revenues to itself. NEPCO suggests that, to ensure that utilities' financial statements are not misleading, this aspect of functional unbundling can and should be accomplished through the ratemaking process, rather than by requiring utilities to actually charge themselves revenues for taking transmission services.[344]

Atlantic City Electric states that the added costs of properly administering and accounting for these transactions separately will increase prices to ultimate consumers. It contends that ensuring that operators do not give undue preference to transactions of the transmission provider makes it unnecessary for a utility to charge itself.

CSW argues that some of the provisions of the tariffs were specifically designed for third parties and do not make sense as applied to the transmission provider (e.g., signing service agreements and running credit checks).[345]

Most IOUs suggest that a revenue credit mechanism be used to account for a transmission provider's use of its system. Florida Power Corp states that revenue credits should be equal to the utility's posted rates for transmission service

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[343]*E.g.*, EEI, Con Ed, VEPCO.

[344]See also NEPCO.

[345]See also Florida Power Corp.

multiplied by the amount of capacity reserved and/or energy transmitted by the utility.

Otter Tail proposes a revenue credit that allocates revenues based on use under the tariff of the utility's transmission investment and credits these revenues against the firm load customers' accounts.

Duke asserts that the transmission provider should maintain records reflecting transmission for its own transactions under the tariff and develop appropriate revenue credits for transmission rates. It also believes that all firm users of the transmission system should receive credits for all non-firm uses.

Allegheny Power states that the crediting of non-firm revenues to network customers would have to be done on an after-the-fact basis when their loads would be known. However, it believes that revenue crediting should occur only if the firm service customer has retained the utility to remarket the customer's unused capacity.

Cajun proposes that all transmission revenues in excess of those implicitly included in the development of the transmission rates, including those that the utility has charged itself, be credited back to the network service transmission customers on a load ratio share basis. If transmission service rates are formula rates that are recalculated annually, Cajun proposes that excess transmission revenues be used to offset the recalculated revenue requirement. If the rates are not formula rates, Cajun states that an explicit tracker with monthly crediting to the network customer must be used.

To avoid cross-subsidization between affiliates and third parties, NRECA suggests that transmission revenues "paid" by a utility's generation function to its transmission function be credited back to the utility's nonaffiliated customers, and that any rate discounts extended to the generation function by the transmission function be filed with the Commission with a full explanation of why the discount was extended together with a showing that the discount was made available to all other similarly situated customers.

APPA contends that the Commission's current system of revenue crediting could give transmission owners an unfair competitive advantage by allowing them to use the revenue credit to subsidize the price at which they sell power. It argues that transmission owners should pay the actual price of transmission rather than booking a revenue credit as an offset to the cost of transmission service.

TAPS and Wisconsin Municipals argue that an essential element of true comparability **[31,702]** is the ongoing pass-through to network customers of a load ratio share of transmission revenues generated by third-party and the transmission provider's off-system uses of the transmission system.

Houston L&P suggests that the revenue crediting mechanism proposed in the NOPR could be established to recognize the utility's transmission service revenue and expenses in non-third-party wheeling transactions by reclassifying a portion of its revenue equal to the cost of transmission services provided to itself during such transactions. This mechanism would not reclassify expense accounts, but would distinguish that transmission portion of

the total transaction's revenue that was associated with covering the cost of transmission service, using the rates charged in similar third-party transactions.

PacifiCorp contends that the Commission should enforce the requirement that utilities account for revenues they pay themselves through the Commission's audit powers and through complaint proceedings. It specifically recommends that each transmitting utility be required to indicate, in its Form No. 1 under Account 456, the megawatts and revenues associated with its firm and non-firm off-system sales.[346]

MT Com states that the embedded costs that the Commission functionalizes for jurisdictional purposes should be carefully reconciled with plant balances used to calculate other costs of service.

CCEM wants each transmission provider to charge and book revenues into separate accounts for (1) service provided to itself and off-system sales and third-party sales under the tariffs, (2) impact study costs that the provider performs for itself or an affiliate, and (3) ancillary service revenues, net of out-of-pocket expenses the transmission owner provides itself or an affiliate.

Arizona Public Service recommends that any revenue crediting or booking be prospective only and that enforcement

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[346]If the utility is not required to file a Form No. 1, PacifiCorp states that it should be required to file similar information annually.

occur through the Commission's periodic audits and a utility's rate cases.

Many IOUs argue that there should be no obligation to credit non-firm transmission revenues to customers who are not using their firm capacity.[347] PacifiCorp contends that all non-firm revenues should be credited against total annual revenue requirements, resulting in lower rates to all customers. Wisconsin P&L maintains that non-firm sales revenue should be shared with all network customers.

Otter Tail argues that non-firm transactions between existing utilities to support and achieve real-time system optimization should be permitted without charge to the transmission owner. CSW asserts that no credits should be made for the non-firm secondary service under the point-to-point tariff and that off-system purchases for native load should not result in a revenue credit.

Southwestern suggests that the Commission not require the crediting of a transmission component associated with off-system purchases by the public utility. Southwestern argues that a credit would interfere with a utility's ability to buy the most economic energy for its native load customers. It also argues that requiring a credit is not comparable to what network customers pay. NEPCO points out that crediting transmission associated with purchases would require native load customers to pay the costs of the utility's purchasing off-system power while network customers do not have to pay a

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[347] *E.g.*, Consumers Power, Northern States Power, PacifiCorp, Allegheny Power.

separate point-to-point charge for their off-system purchases. Southwestern claims that the crediting requirement would double-charge the transmitting utility and its native load customers because a utility's off- system purchases directly relate to the load it serves, and that load already is reflected in the transmission rate calculation. Southwestern also claims that it is unclear from the NOPR whether the Commission considers sales from the renewal of existing wholesale requirements contracts as being subject to crediting. It argues that transmission related to these sales should not be subject to the crediting requirement because this is service to native load customers.

[31,703]

Brazos opposes imputing revenues associated with a utility's own use of its transmission system because this will artificially increase the cost of power and deny consumers the benefits of economy energy sales made at market-based prices. Commission Conclusion

While we used the word "accounting" in the NOPR, the real issue is assuring that utilities bear the costs associated with their own uses of the system in a manner comparable to how they charge others. Accordingly, this is a rate issue, not an accounting issue. However, we direct utilities to account for all uses of the transmission system and to demonstrate that all customers (including the transmission provider's native load) bear the cost responsibility associated with their respective uses.[348]

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[348]Additional guidance on this subject is in Section IV.G.4.g.(2)(a).

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[pp. 31,718 - 31,736]

[31,718]

b. Services that May Be Offered and Sold as a Package

The NOPR indicated that ancillary services must be offered separately from one another but did not indicate if the transmission provider may also offer a package of ancillary services.

Comments

Several commenters support giving customers the option either to purchase ancillary services as separate and distinct services or to purchase a package of services from the transmission provider.[394] Others, such as Tallahassee, recommend that utilities be prohibited from bundling the purchase of one service with another so that a transmission customer cannot **[31,719]** rely on the transmission provider for just one or a few of the ancillary services.

EEI and ELCON argue that the Commission should permit customers the option to request that transmission providers offer packages of selected ancillary services.[395] They and other commenters express a concern that

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[394]*E.g.*, Direct Service Industries, Mt. Hope Hydro, ELCON, PA Com.

[395]EEI Initial Comments at V-4; ELCON Initial Comments at p. 21.

efficiencies can be lost under a policy that precludes combining ancillary services.

Commission Conclusion

We conclude that a transmission provider must offer and price the individual ancillary services separately. It may not tie the purchase of one to the purchase of another.

However, we will allow a transmission provider to assemble packages of ancillary services (not bundled with basic transmission service) that can be offered at rates that are less than the total of individual charges for the services if purchased separately. It may also offer rate discounts on any ancillary service. If a rate discount is offered to the transmission owner itself or to an affiliate of the transmission owner, the same discount must be offered to non-affiliates, as well. In addition, discounts offered to non-affiliates must be on a basis that is not unduly discriminatory. All discounts must be posted on the transmission provider's OASIS.

4. Reassignment of Ancillary Services

In the NOPR, the Commission noted that ancillary services may not be suitable for reassignment and requested comments on this issue.

Commenters express divided views on the reassignment issue. Some IOU commenters believe that, subject to technical limitations, ancillary services could be

reassigned.[396] Other commenters, including many IOUs, oppose reassignment because they believe it is impractical.[397] In particular, PacifiCorp claims that the customer-specific nature of generation-related ancillary services prevents such services from being reassigned.

TDU Systems argue that transmission customers that must pay for ancillary services they do not need should be able to resell them to someone else.[398] Mt. Hope Hydro claims that, if a bulk power transaction and the associated transmission service can be reassigned, it is reasonable that the ancillary services used to support the transaction also should be reassigned, particularly if the same facilities and contract path are used.[399]

Commission Conclusion

We conclude that transmission customers will be allowed to reassign ancillary services along with the reassignment of basic transmission service. The Commission believes that a policy of transmission capacity reassignment may not be possible unless the ancillary services used to support the transmission are also reassignable.

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[396]*E.g.*, WP&L, NYSEG.

[397]*E.g.*, Consumers, PacifiCorp, Carolina P&L, PSNM, Salt River, PA Com, TDU Systems.

[398]TDU Systems Initial Comments at p. 87.

[399]Mt. Hope Hydro Initial Comments at p. 17.

5. Pricing of Ancillary Services

In the NOPR, we asked for comments on ancillary service pricing and proposed specific ancillary services prices in the Stage One implementation rates. Many commenters commented on the Stage One rates. There is no Stage One in the Final Rule.

Many commenters state that ancillary services are difficult to price. They suggest diverse pricing approaches. IN Com notes that, because utilities and regulatory commissions have no experience with pricing unbundled ancillary services, the process needs to evolve but the goal should be to encourage market pricing in competitive markets. Air Liquide believes the best pricing policy should be negotiated bilateral agreements, provided market power is mitigated.

Other commenters express concern about how pricing proposed in the NOPR would affect the development and operation of competitive ancillary services markets. Industrial Energy Applications notes that low price caps on generation-related services, such as supplying losses, imbalance energy, operating reserve and backup power, which can be provided from many sources, inhibit competitive **[31,720]** market development. There is little incentive for other providers to invest in facilities to provide these services. Dayton P&L and others contend that the Commission should not require transmission providers to provide generation-based ancillary services at cost-based rates and then allow third parties to resell such services at market-based rates. PacifiCorp expresses concern that the NOPR's pricing proposal would be overly restrictive in the emerging competitive market for generation-related ancillary services.

Many commenters argue that cost-based price caps are appropriate for ancillary services if there are no alternative suppliers or until competitive markets develop.[400] CAMU suggests that the comparability standard is not met if market rates exceed the costs of providing ancillary services. Allegheny, Ohio Edison and Atlantic City support cost-based pricing for Reactive Power/Voltage Control. Ohio Edison recommends cost-based pricing for frequency regulation, and Atlantic City recommends it for scheduling and dispatch.

Several commenters suggest that the Commission require cost-based rates for ancillary services where no source other than the transmission provider exists and market-based rates for generation-related ancillary services if competition exists.[401] Washington and Oregon Energy Offices recommend that, before permitting market-based rates, at least two other non- affiliated parties should be able to offer a nearly identical ancillary service and that the Commission should use the same standards for allowing market-based rates for ancillary services that it has used for wholesale power sales. Mt. Hope Hydro argues that vertically integrated utilities should be permitted to charge cost-based rates that are limited to no more than the market price for ancillary services. It also contends that companies whose generation facilities are not supported by captive retail or transmission customers should be authorized to sell at market-based prices.

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[400] *E.g.*, Utilities For Improved Transition, Idaho, CINergy, Direct Service Industries, Mt. Hope Hydro, ABATE, TDU Systems, Missouri-Kansas Industrials, Washington and Oregon Energy Offices, IN Com.

[401] *E.g.*, PJM, Texas Utilities, Entergy, Carolina P&L.

The vast majority of commenters from all interest groups who address market-based pricing for ancillary services agree that market-based pricing is appropriate for ancillary services where competitive market conditions exist. However, commenters disagree over whether a competitive market for ancillary services currently exists.

In determining the extent of competition, many commenters distinguish between ancillary services that are (1) generation- related and (2) transmission-related. Commenters disagree over whether the Commission can declare generation-related ancillary services to be competitive on a generic basis. Many commenters contend that transmission-related ancillary services are not available in a competitive market; consequently, they agree that prices for such services should be cost-based.

Commission Conclusion

We will consider ancillary services rate proposals on a case-by-case basis.

In response to comments,[402] we offer here some general guidance on ancillary services pricing principles.

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[402]Many commenters were particularly concerned that rates for energy losses, a NOPR ancillary service, should be market-based. We need not address this concern in this Rule, however, because we will not require Real Power Losses to be offered as an ancillary service.

(1) Ancillary service rates should be unbundled from the transmission provider's rates for basic transmission service, even though such services are a necessary adjunct to basic transmission service.

(2) The fact that we have authorized a utility to sell wholesale power at market-based rates does not mean we have authorized the utility to sell ancillary services at market-based rates.

(3) In the absence of a demonstration that the seller does not have market power in such services, rates for ancillary services should be cost-based and established as price caps, from which transmission providers may offer a discount to reflect cost variations or to match rates available from any third party. If a rate **[31, 721]** discount is offered to the transmission owner itself or to an affiliate of the transmission owner, the same discounted rate must be offered to non-affiliates, as well. In addition, discounts offered to non-affiliates must be on a basis that is not unduly discriminatory. All discounts must be posted on the transmission provider's OASIS.

(4) The amount of each ancillary service that the customer must purchase, self-supply, or otherwise procure must be readily determined from the transmission provider's tariff and comparable to the obligations to which the transmission provider itself is subject. The provider must take ancillary services for its own wholesale transmission under its own tariff.

(5) The location and characteristics of a customer's loads and generation resources may affect significantly the

level of ancillary service costs incurred by the transmission provider. Ancillary service rates and billing units should reflect these customer characteristics to the extent practicable.

6. Accounting for Ancillary Services Comments

Some commenters suggest that there may be a need for revising the Uniform System of Accounts to track better the costs of providing discrete ancillary services. Other commenters believe that ancillary services are transmission-type services and suggested that the costs of generation-provided ancillary services be refunctionalized from power production expense to transmission expense.

Oak Ridge asserts that a primary goal of those interested in restructuring the electricity industry should be to identify clearly the different functions that are today buried within the vertically integrated utility and bundled into one price. Oak Ridge, however, indicates that achieving this ideal of identifying unbundled services at appropriate prices will be difficult because of utility accounting practices.

EEI asserts that since the current Uniform System of Accounts was designed to track costs incurred to provide bundled wholesale service, it does not track the discrete costs incurred to provide ancillary services. Therefore, according to EEI, a major update is needed to support the pricing of discrete ancillary services.

ConEd states that ancillary services are integral and essential elements of providing transmission services. It notes that, historically, due to the vertical integration of utilities, those services have been bundled with the other services

provided and the costs associated with providing ancillary services have not been specifically defined. ConEd claims that to a large degree, this is due to the fact that utility accounting mechanisms were not established with the intention of identifying the costs for ancillary services.

UI asserts that if transmission customers are to be charged for certain ancillary services, it may be necessary to refunctionalize certain specific costs items from generation to transmission. UI points out that some of the reactive power to support system voltages and to provide transmission services, for example, is supplied from the variable reactive output of the generators. It states that these costs, to the extent they can be identified with the provision of transmission service, should be refunctionalized to the transmission account. However, UI states it may not be possible to develop a unit cost for specific transactions. Thus, UI states it may be more appropriate to roll these costs into the embedded transmission rate and allocate them among the various users of the transmission system.

Commission Conclusion

To ensure comparable transmission access a Transmission Provider is obligated to offer or arrange to provide certain ancillary services to the Transmission Customer. Also, the Transmission Provider may offer to provide other ancillary services to the Transmission Customer. A Transmission Customer is obligated to purchase certain ancillary services from the Transmission Provider.

Generation resources provide certain ancillary services, while transmission resources provide other ancillary

services. Consequently, the costs of providing certain ancillary services are recorded in the utility's power production expense accounts, while others are recorded in the utility's transmission expense accounts.

Currently, the Uniform System of Accounts requires that costs incurred in providing ancillary services be recorded as power production or transmission expense depending upon which resource the utility uses to supply the service. At this time, **[31,722]** we are not convinced that the amounts involved or the difficulty associated with measuring the cost of ancillary services warrants a departure from our present accounting requirements. We will specify, however, that revenues a Transmission Provider receives from providing ancillary services must be recorded by type of service in Account 447, Sales for Resale, or Account 456, Other Electric Revenues, as appropriate.

E. *Real-Time Information Networks*

In the Open Access NOPR, the Commission determined that in order to remedy undue discrimination, a utility must functionally unbundle its wholesale services, and that among the things required by functional unbundling is that the utility, when buying or selling power, rely upon the same electronic network that its transmission customers rely upon to obtain transmission information. Accordingly, the Commission accompanied its issuance of the Open Access NOPR with issuance of a notice of technical conference that initiated a proceeding in Docket No. RM95-9-000 to consider whether Real-Time Information Networks (RINS) or some other option would be the best means to ensure that potential customers of transmission services have access to the

information necessary to obtain open access transmission service on a non-discriminatory basis.[403]

The Commission affirms its conclusion that in order to remedy undue discrimination in the provision of transmission services it is necessary to have non-discriminatory access to transmission information, and that an electronic information system and standards of conduct are necessary to meet this objective. Therefore, we issue, in conjunction with this Final Rule, a final rule adding a new Part 37 that requires the creation of a basic OASIS and standards of conduct.[404]

The Phase I OASIS rules require each public utility (or its agent), as defined in section 201(e) of the Federal Power Act, 16 U.S.C. 824(e), that owns, controls, or operates facilities used for the transmission of electric energy in interstate commerce to develop and/or participate in an OASIS. The Phase I OASIS rules describe what information must be provided on the OASIS during Phase I and how OASIS must be implemented.

In addition, the new Part 37 contains a code of conduct applicable to all transmission providing public utilities. The code of conduct is designed to ensure that preferential access to information about wholesale transmission prices and

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[403]See Real-Time Information Networks, Notice of Technical Conference and Request for Comments, 60 FR 17726 (April 7, 1995).

[404]In Phase II, we will continue to develop the requirements for fully functional OASIS. We expect to issue a final rule on Phase II OASIS requirements sometime in 1997.

availability is not available to employees of the public utility engaged in wholesale marketing functions or to employees of certain of the public utility's affiliates.

F. Coordination Arrangements: Power Pools, Public Utility Holding Companies, Bilateral Coordination Arrangements, and Independent System Operators Comments

Timing of Reformation

Many marketers, IPPs, and other nonmembers of pools request that the Commission immediately apply unbundling and transmission tariff requirements to all new transactions under existing pooling agreements. APPA states that the Commission should not deal with power pools as a "follow-on activity" because treatment of pools is an integral step in achieving transmission comparability. AEC contends that until pools publish open access tariffs, the Commission should permit applications for section 211 transmission orders from one or more applicants directed to multiple respondents.

Existing pools generally urge the Commission to allow time for the pools to propose alternative structures or agreements which would meet the objectives of the final rule. EEI states that the rule may create problems for power pools that will not be examined or understood by the Commission and the public until the Commission's pooling inquiry is completed; it requests that the pooling inquiry be completed before a final rule is issued. Duke recommends that implementation of open access transmission services by power pools be addressed in a separate proceeding because implementation **[31,723]** of open access for power pools raises complex issues.

EGA, among others, argues that new transactions under existing pooling agreements should not be grandfathered, but rather should be required to meet the functional unbundling requirements of the final rule. Some pool members argue that pool transactions are largely not wholesale transactions. For example, PECO (a member of PJM) requests the Commission to clarify that the delivery of pooled generation to pool members' native load is not a "wholesale purchase" of power and thus would not require taking transmission service under one's own open access transmission tariff. Another member of PJM, BG&E, interprets the proposed rule to require all PJM economy trades to be firm point-to-point services; it claims that such a requirement "jeopardizes the continued viability of the pool."

System-Wide Tariffs

Virtually all commenters on power pool issues state that the tariff requirements should not be applied directly to individual utilities who are members of "tight" power pools. ELCON, CCEM, and others argue that the pro forma tariff requirement should be applied directly to "tight" or "single system" power pools to avoid discriminatory "pancaking" of transmission rates. However, Duke argues that where there are both multiple owners and operators, as in "loose" pools, it is appropriate to have individual tariffs unless the pool members agree otherwise. DOE recommends a power pool file a single pool-wide tariff to offset problems associated with joint ownership or control of transmission. CT DPUC recommends that the Commission provide guidance for transmission access and pricing (so as to avoid needless disruption of present methods).

Flexible Treatment

Most commenters on power pools support recognizing regional differences among power pools and urge flexibility. PSE&G (a member of PJM) states that open access tariffs must be specially crafted to deal with power pool members. NYPP and PJM state that they are considering innovations and urge that their efforts not be stifled by any final rule. CSW proposes a region-wide pricing model based on power flows. NPPD, a member of the Mid-Continent Area Power Pool (MAPP), says MAPP is considering adopting the megawatt-mile approach to transmission pricing. SoCal Edison states that California utilities are developing a market-based power pool and that it is crucial for the final rule to be flexible to permit innovations throughout the country.

ELCON and power marketers, however, argue for uniformity and point out the difficulties of moving power from system to system where each system has varying standards or "pool rules." These commenters support uniform application of the terms and conditions in the pro forma tariffs to create a national standard.

NEPOOL emphasizes that since pools remain voluntary, the imposition of rules that are not acceptable to pool members simply increases the likelihood that members will withdraw and pools will disintegrate. For this reason, NEPOOL states that solutions to enhance competition (within a tight pool setting) are best identified through the consensus of pool members, which requires both time and flexibility on the part of the Commission.

DE, DC, NJ and MD Coms emphasizes its concern that a one-size-fits-all open-access policy, while perhaps benefiting subsets of individual suppliers and purchasers, may not be the best solution for the millions of retail customers who currently rely on power pools.[405] It wants the Commission to be aware that the individual commissions have begun a formal dialog among each other and with the PJM utilities to discuss possible regional solutions to transitional competitive issues.

Open Membership

NIEP and CCEM argue that the competitive playing field cannot be level unless nonmembers receive certain power pool services on terms comparable to those for pool members. Members of pools state that "return in kind" transactions are efficient, but that such transactions are not appropriate for those entities that **[31,724]** are not similarly situated to vertically integrated utilities.

EEI maintains that those seeking the benefits of pool membership must accept the burdens imposed on existing pool members (otherwise, they would have an advantage, not comparability). EEI believes that new pool participants can negotiate and "buy into" the pool resources. Many commenters claim that unbundling certain power pool services to accommodate open access will solve the problem.

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[405] *E.g.*, DE Com, DC Com, NJ Com, MD Com.

MidAmerican states that if the Commission grants nonmembers access to pool transmission service, the Commission should allow a period of at least four years for pools to restructure and refile rate schedules to avoid the inequitable results which the Commission's requirements will impose on pool members.

MidAmerican contends that the Commission should authorize pool members to unilaterally withdraw from their pools if any restructuring or revision of rate schedules is unacceptable to the member. Holding companies

Allegheny, Southern, and other holding companies argue that coordination agreements among subsidiaries of a utility holding company system do not constitute a power pool and should not be subject to any obligations the Commission may place on power pools. Bilateral Coordination Agreements

Ohio Edison requests clarification that the Commission is not requiring new wholesale coordination transactions to be under the open access tariffs; they may be continued under existing coordination agreements. It stresses the importance of such agreements in making economy and emergency transactions.

A number of commenters agree that existing coordination contracts should not be abrogated or modified, and that transactions under these existing contracts should not be governed by the provisions of the pro forma tariffs.[406]

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[406] *E.g.*, Central Louisiana, Dayton P&L, LPPC, MEAG, Missouri Basin Group, Montana-Dakota Utilities, Nebraska Public

These commenters generally argue that existing coordination agreements should not be abrogated or amended by the final rule because: (1) they were not negotiated in the environment envisioned by the NOPR; (2) coordination sales are beneficial to consumers and ratepayers (and thus it would not be in the public interest to curtail them); and (3) the termination of coordination agreements, which in some cases have been in place for years and are tailored to parties' peculiar circumstances, could cause severe hardships in certain regions (especially with regard to scheduling and curtailment).

PSNM contends that such agreements are the result of mutually beneficial bargaining. LPPC and MEAG argue that current contracts negotiated among parties provide cost savings to consumers, which may be foregone if existing contracts are modified. Central Louisiana suggests that the pro forma tariff provisions should be flexible enough to achieve comparability if applied to both existing and new coordination agreements.

Some commenters argue that there may be cases where it is inappropriate to modify existing coordination agreements to satisfy the requirements of the rule. They assert that coordination agreements providing for emergency transactions,[407] reliability,[408] and resource efficiency gains[409]

Power District, Ohio Edison, PSNM.

[407] *E.g.*, Arizona, Ohio Edison.

[408] *E.g.*, Soyland, NRECA.

[409] *E.g.*, APPA.

need special attention. However, Soyland believes that existing agreements need to be reviewed if there is substantial increase in wholesale power market transactions, at the customer's option. TDU Systems argues that coordination contracts supporting system reliability should be honored and given scheduling and curtailment preference. TDU Systems contends that any amendments should be at the parties' discretion rather than by Commission mandate.

Several commenters suggest that the proposed rule is unclear about whether only existing transactions under agreements already approved by the Commission will be exempt from functional unbundling, or whether the proposed rule also would exempt (or grandfather) new transactions entered into pursuant to existing approved contracts.[410] Other commenters recommend that the Commission **[31,725]** clarify that its policy on unbundling applies to all new transactions, whether pursuant to new or existing agreements.[411] ConEd and KCPL request clarification that purchases made to satisfy retail service are not subject to the requirements of the pro forma tariffs.

CCEM argues that all coordination transactions, including new transactions under existing agreements, should be unbundled to ensure that transmission providers are implementing the posted transmission rate. CINergy contends that the comparability standard should be applied to existing coordination agreements, including buy-resell agreements, to

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[410] *E.g.*, APPA, CCEM, EGA.

[411] *E.g.*, APPA, CCEM, LG&E, EGA.

mitigate any unfair bulk power market advantages. Functional unbundling would ensure that a utility includes an EBB-posted transmission rate in the transaction charge. CINergy and Power Marketing Association recommend that the Commission use its authority under section 206 to require all utilities to file amendments to their existing coordination agreements providing for transmission service to be taken pursuant to the parties' open access transmission tariffs. Power Marketing Association further recommends that the Commission establish expedited procedures to address the situation arising from conflicting pro forma tariffs and existing coordination provisions.

Tallahassee also believes that the comparability standard should be applied to existing coordination agreements, but Tallahassee recommends that the Commission establish a transition period to allow for renegotiation among parties rather than imposing modifications to existing agreements. Renegotiation would provide an opportunity to retain previously bargained-for benefits. Detroit Edison also contends that many of the existing coordination agreements do not provide for the services required under the pro forma tariffs. Like Tallahassee, Detroit Edison recommends that the Commission allow sufficient time for parties to renegotiate existing agreements. CINergy suggests a three-year transition period.

Coordination Pricing Practices

EEI and PJM disagree with the Commission's assertion that current coordination pricing is no longer just and reasonable in the absence of an open access tariff. Ohio Edison and PA Com question the basis of the Commission's

preliminary conclusion that current coordination pricing is no longer justified in the absence of a seller's tariff offer of non-discriminatory open access transmission services. PA Com asserts that the Commission's underlying assumption of general lack of transmission access by wholesale customers has not been established as fact in the proposed rule.

MN DPS supports current coordination pricing methods provided that utilities have executed open-access tariffs. Missouri Basin Group argues that, if increased market competition materializes through open access, utilities will decreasingly rely on current coordination pricing if it no longer produces the most beneficial outcome. Missouri Basin Group recommends the Commission simply allow utilities to choose a pricing method even if a utility opts for a less beneficial outcome. Nebraska Public Power District also urges the Commission to avoid mandating coordination pricing methods. Nebraska Public Power District is concerned that this may impede establishing RTGs where such pricing is by mutual agreement and subject to ADR procedures.

Several commenters agree that current coordination pricing may no longer be appropriate in an open access regime.[412] FL Com believes that current coordination pricing should be replaced by market-based rates if open access transmission service is imposed by the Commission.

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[412] *E.g.*, Arizona, CINergy, Consumers Power, EEI, PJM.

Commission Conclusion

The term "coordination" is applied to a wide variety of wholesale power sales agreements within the industry, including interchange, interconnection, pooling, and other agreements. Broadly speaking, any non-requirements power sales agreement can be considered to be a coordination agreement.[413]

The Final Rule's general requirement for non-discriminatory transmission access **[31,726]** and pricing by public utilities, and its specific requirement that public utilities unbundle their transmission rates and take transmission service under their own tariffs, apply to all public utilities' wholesale sales and purchases of electric energy, including coordination transactions. The Commission has determined that certain existing wholesale coordination arrangements and agreements must be modified to ensure that necessary transmission services for such arrangements and agreements are taken under open access transmission tariffs and thus that such arrangements and agreements are not unduly discriminatory. Below we discuss how and when various types of coordination agreements will need to be modified, and when public utility parties to coordination agreements must begin to trade power under those agreements using transmission service obtained under the same open access transmission tariff available to non-parties.

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[413]For example, a 30-year contract to supply 50 MW of power can be considered to be a coordination arrangement because it is not a contract to meet all of the buyer's power requirements.

Coordination arrangements, and the agreements governing them, vary widely. They range from relatively simple bilateral arrangements to complex tight power pools. Our discussion addresses four broad categories of arrangements and accompanying agreements: "tight" power pools, "loose" power pools, public utility holding company arrangements, and bilateral coordination arrangements. For purposes of implementing the non- discriminatory, open access requirements of the Final Rule, we are dividing bilateral coordination agreements into two general categories: bilateral economy energy agreements and other bilateral coordination agreements. Economy energy agreements typically provide for short-term economy trading "if, as, and when available" and are generally driven by the buyer and seller's generation costs. They do not require either the seller or the buyer to engage in a particular transaction. Other coordination agreements are typically longer term or open-ended. Some may involve joint ownership or joint planning of generation.[414] Others may provide joint operation of facilities so that the parties can coordinate their maintenance schedules or provide one another with emergency service. These longer-term coordination agreements are distinguished from short-term economy trading agreements in that the parties have undertaken a contractual obligation to operate their facilities so as to support one another under the conditions specified in the arrangements.

As noted in the NOPR, power pools, in contrast to most bilateral arrangements, present complex issues that may

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[414] Agreements dealing with joint ownership or operation of transmission facilities are discussed at Section IV.C.3.

require special implementation requirements.[415] This is because these arrangements may involve agreements containing an intricate set of rights, obligations, and considerations among the members of a pool. We provide for implementation requirements herein that vary depending upon the type of "pooling" arrangement involved.

The Commission has concluded that in order to adequately remedy the undue discrimination in transmission access and pricing by public utilities that are members of power pools or other coordination arrangements, such public utilities must remove preferential transmission access and pricing provisions from agreements governing their transactions. The filing of open access tariffs by the public utility members of a power pool is not enough to cure undue discrimination in transmission if those public utilities can continue to trade with a selective group within a power pool that discriminatorily excludes others from becoming a member and that provides preferential intra-pool transmission rights and rates. The same holds true of certain bilateral arrangements that allow preferential transmission pricing or access. These arrangements and agreements need to be changed. We expect such arrangements and agreements to be **[31,727]** modified by the dates indicated in this Rule.

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[415]The Commission did not define what it meant by "power pools" in the NOPR discussion. We use the term power pool in a very broad context here and have generally characterized three broad types of arrangements that represent some form of pooling: "tight pools", "loose" pools and other multilateral coordination arrangements, and holding companies. Even between the categories of tight and loose pools, however, there is no bright dividing line.

However, if necessary, we will institute section 206 proceedings against public utilities that do not make such filings.

The Commission's technical conferences on power pools, ISOs, and pro forma tariffs made clear to us the need to articulate guidance in this Rule on the restructuring or modification of unduly discriminatory coordination arrangements -- particularly tight power pools.[416] They also made clear that members of tight power pools, in particular, need time to make the necessary modifications to these arrangements. We recognize that members of some power pools are already in the process of formulating voluntary modifications to pooling agreements to be filed with the Commission (e.g., PJM, NYPP, NEPOOL). Therefore, we will provide adequate time for these filings as well as guidance to changes that need to be made.

In addition, although we do not at this time find it necessary to require power pools to form an independent system operator in order to remedy undue discrimination, we believe ISOs may prove to be an effective means for accomplishing comparable access.[417] We recognize that

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[416]A technical conference on pro forma tariffs was held on October 27, 1995. A technical conference on power pools was held on December 5 and 6, 1995 and a follow-up technical conference on ISOs and power pools was held on January 24, 1996.

[417]The DOJ and DOE suggested that the Commission examine operational unbundling as a way of enforcing comparability in transmission service. DOJ and DOE believe that functional unbundling may not be adequate to ensure comparability

several utilities are exploring the possibility of forming ISOs. For example, discussions are ongoing in California, PJM, NYPP, and the Midwest. Therefore, because of the industry's interest (which we share) in the concept of an ISO and the potential for an ISO to provide non-discriminatory transmission services to all market participants, we will provide guidance in this section on minimum ISO characteristics.

1. Tight Power Pools

For purposes of this Rule, the tight power pools are: New York Power Pool (NYPP), New England Power Pool (NEPOOL), Pennsylvania-New Jersey-Maryland Interconnection (PJM), and the Michigan Electric Coordinated Systems (MECS).

Public utilities who are members of a tight pool must file, within 60 days of publication of the Final Rule in the Federal Register, either: (1) an individual Final Rule pro forma tariff; or (2) a joint pool-wide Final Rule pro forma tariff. They are not required to take service for pool transactions under the tariff that is filed within 60 days. However, they will be required to file a joint pool-wide Final Rule pro forma tariff no later than December 31, 1996, and must begin to take service under that tariff for all pool

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and so have recommended that some form of operational unbundling be required. While we believe that requiring this is premature, we note that an ISO is one way to achieve operational unbundling and we encourage the voluntary development of ISOs.

transactions no later than December 31, 1996. The purpose of this extension is to allow sufficient time for tight pools to amend their pooling agreements and to restructure their operations to conform to the requirements of the Final Rule. We also believe that the additional time is necessary to preserve efficient trading arrangements during the restructuring period.

The Commission therefore will require that the public utility members of tight pools file reformed power pooling agreements no later than December 31, 1996. The reformed power pool agreements should establish open, non-discriminatory membership provisions (including establishment of an ISO, if that is a pool's preferred method of remedying undue discrimination) and modify any provisions that are unduly discriminatory or preferential. The membership provision must allow any bulk power market participant to join, regardless of the type of entity, affiliation, or geographic location.

If the reformed agreement allows members to make transmission commitments or contributions in exchange for the discounted transmission rates, the pool may file a transmission tariff that contains an access fee for non-transmission owning members or non-members, justified solely on the basis of transmission-related costs. Alternatively, the pool could make available **[31,728]** a transmission rate that is structured the same as the discounted rate (e.g., non-pancaked) but with a higher rate that is justified on the basis of transmission-related costs borne (or contributed) by the pool members. However, any such access fee or higher rate must be justified solely on the basis of transmission costs and cannot be tied to the costs of any other

agreement among the pool members (e.g., generation reserve sharing).

2. Loose Pools

For purposes of the Final Rule, a loose pool is any multi- lateral (more than 2 public utilities) arrangement, many of which contain discounted and/or special transmission arrangements. Examples are MAPP, Inland Power Pool, and the MOKAN pool. Other entities may qualify to be treated as a loose pool if they can show that they meet the definition above.

Public utilities within a loose pool must file, within 60 days of publication of the Final Rule in the Federal Register, either: (1) an individual Final Rule pro forma tariff; or (2) a pool-wide Final Rule pro forma tariff. They are not required to take service for pool transactions under the tariff that is filed within 60 days. However, they will be required to file a joint pool-wide Final Rule pro forma tariff no later than December 31, 1996, and must begin to take service under that tariff for all pool transactions no later than December 31, 1996. The purpose of this extension is to allow sufficient time for loose pools to amend their agreements and to restructure their operations to conform to the requirements of the Final Rule. We also believe that the additional time is necessary to preserve efficient trading arrangements during the restructuring period.

The Commission therefore will require that the public utility members of loose pools file reformed power pooling agreements no later than December 31, 1996. They also must file a joint pool-wide tariff no later than December 31, 1996.

The reformed power pool agreements should establish open, non-discriminatory membership provisions and modify any provisions that are unduly discriminatory or preferential. The membership provision must allow any bulk power market participant to join, regardless of the type of entity, affiliation, or geographic location.

The Commission recognizes that loose pools typically do not operate as a single control area and that operational unbundling, perhaps through an ISO, might not be readily attainable at this time. Nonetheless, we encourage the members of loose pools to explore the advantages of the ISO concept.

If the reformed agreement allows members to make transmission commitments or contributions in exchange for discounted transmission rates, the pool may file a transmission tariff that contains an access fee for non-transmission owning members or non-members, justified solely on the basis of transmission-related costs. Alternatively, the pool could make available a transmission rate that is structured the same as the discounted rate (e.g., non-pancaked) but with a higher rate that is justified on the basis of transmission-related costs borne (or contributed) by the pool members. However, any such access fee or higher rate must be justified solely on the basis of transmission costs and cannot be tied to the costs of any other agreement among the pool members (e.g., generation reserve sharing).

3. Public Utility Holding Companies

Public utility members of registered and exempt holding companies that are also members of tight or loose

pools are subject to the tight and loose pool requirements set forth above. The remaining holding company public utility members, with the exception of the Central and South West (CSW) System, are required to file a single system-wide Final Rule pro forma tariff permitting transmission service across the entire holding company system at a single price within 60 days of publication of the Final Rule in the Federal Register (service companies may, of course, file on behalf of their public utility affiliates). As discussed below, CSW presents special circumstances.

The CSW System is comprised of four operating public utilities. Two of those utilities, Southwestern Electric Power Company (SWEPCO) and Public Service Company of Oklahoma (PSO) operate in the Southwest Power Pool (SPP). The other two, West Texas Utilities Company (West Texas) and Central Power and Light Company (CP&L), operate in the Electric Reliability Council of Texas (ERCOT). SWEPCO and PSO exchange power with West Texas and CP&L **[31,729]** through two high voltage, direct current interconnections (the North and East Interconnections).[418]

Pursuant to the Commission orders concerning the North and East Interconnections, CP&L, West Texas, SWEPCO, and PSO have on file what are referred to as the

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[418]The North and East Interconnections were ordered by the Commission pursuant to sections 210, 211 and 212 of the Federal Power Act. See *Central Power and Light Company, et al.*, 17 FERC ¶61,078 (1981), order on reh'g, 18 FERC ¶61,100 (1982); 40 FERC ¶61,077 (1987).

"to or from and over tariffs."[419] Those tariffs apply only to transmission service that involves the delivery of power and energy to or from and over the North and East Interconnections.[420] The tariffs do not apply to the transmission of power for CSW subsidiaries other than the operating companies. The tariffs in many respects are different from the Final Rule pro forma tariff and do not provide comparable services. Moreover, the pricing provided in the "to or from and over" tariffs is different from the pricing set forth in the Texas Commission's final open access rule.[421]

Given these special circumstances, we believe it appropriate to give CSW the opportunity to propose a solution to achieving comparability for the CSW system. Accordingly,

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[419]Houston Lighting and Power Company (HL&P) and Texas Utilities Electric Company (TU) also have on file "to or from and over tariffs" pursuant to the Commission orders.

[420]*See, e.g.*, CP&L and West Texas Interpool Transmission Service Tariff, §4.1.

[421]Compare 21 TEX REG 1397, LEXIS, mimeo at p. 18 (adopting hybrid pricing scheme with 70% of transmission rate based on regional postage stamp method and 30% based on the vector-absolute megawatt-mile method) with Id. at Article III.

We note that the Texas Commission concluded that the ERCOT portion of the costs of the North and East Interconnections "should be included in the cost of service, when the owners of the (Interconnections) amend the FERC tariffs for the use of the (Interconnections) to provide equal access to other utilities. 21 TEX REG, LEXIS, mimeo at p. 24.

we direct the public utility subsidiaries of CSW to consult with the Texas, Arkansas, Oklahoma and Louisiana Commissions and to file not later than December 31, 1996 a system tariff that will provide comparable service to all wholesale users on the CSW System,[422] regardless of whether they take transmission service wholly within ERCOT or the SPP, or take transmission service between the reliability councils over the North and East Interconnections.[423]

The Commission will give public utilities that are members of holding companies an extension of the requirement to take service under the system tariff for wholesale trades between and among the public utility operating companies within the holding company system. This extension is until December 31, 1996 -- the same extension we are granting to power pools. At that point, the public utility operating companies will be required to take service

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[422]It may be appropriate to have different rates for transmission service wholly within ERCOT or the SPP, and for service between the reliability councils. However, the same rates, terms, and conditions applicable for third parties should also be applicable to the CSW System's wholesale transmission requirements.

[423]We recognize that this action may require amendment to the Commission's orders under FPA sections 210, 211, and 212, ordering the North and East Interconnections. In this regard, it should be clearly understood that the Commission's action in requiring comparable service by the CSW System is not in any way intended to result in public utility status to any ERCOT participants that are not public utilities -- e.g., HL&P and TU. See 16 U.S.C. 824(b)(2).

under the Final Rule pro forma tariff for wholesale trades among themselves. In addition, it may be necessary for registered holding companies to reform their holding company equalization agreement to recognize the non-discriminatory terms and conditions of transmission service required under the Final Rule pro forma tariff.

4. Bilateral Coordination Arrangements

Any bilateral wholesale coordination agreement executed after the effective date of this Rule will be subject to the functional unbundling and open access requirements set forth in this Rule. With regard to existing bilateral agreements, however, the diversity of the types of agreements currently on file presents special implementation problems. The Commission is particularly concerned with future economy energy transactions that may occur pursuant to existing umbrella-**[31,730]**type coordination agreements. Accordingly, we shall require all bilateral economy energy coordination contracts executed before the effective date of this Rule to be modified to require unbundling of any economy energy transaction occurring after December 31, 1996. All non- economy energy bilateral coordination contracts executed before the effective date of this Rule will be permitted to continue in effect, but will be subject to complaints filed under section 206 of the FPA. Under those procedures, the rates, terms, and conditions of individual coordination contracts may be challenged as unduly discriminatory or otherwise unlawful.

To compute the unbundled coordination compliance rate, the utility must subtract the corresponding transmission unit charge in its open access tariff from the existing

coordination rate ceiling. For example, if a utility has a coordination rate ceiling for hourly service of incremental cost plus 15 mills/kWh and a transmission tariff rate for hourly service of 3 mills/kWh, it shall revise the coordination rate ceiling to incremental cost plus 12 mills/kWh. The Commission cautions that the compliance filing will be strictly limited to removing the current transmission tariff price from the coordination price and will not be a medium for otherwise revising the residual coordination sales price.

The transmission rate for the coordination transactions may be at or below the tariff rate. However, if a utility's transmission operator offers a discounted transmission rate to the utility's wholesale marketing department or an affiliate for the purposes of coordination transactions, the same discounted rate must be offered to others for trades with any party to the coordination agreement. In addition, discounts offered to non-affiliates must be on a basis that is not unduly discriminatory.[424] This may require parties to file modifications of the coordination arrangements.

ISO Principles

The Commission recognizes that some utilities are exploring the concept of an Independent System Operator and that the tight power pools are considering restructuring proposals that involve an ISO. While the Commission is not requiring any utility to form an ISO at this time, we wish to encourage the formation of properly-structured ISOs. To this

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[424]All discounts must be posted on the transmission provider's OASIS.

end, we believe it is important to give the industry some guidance on ISOs at this time. Accordingly, we here set out certain principles that will be used in assessing ISO proposals that may be submitted to the Commission in the future.

These principles are applicable only to ISOs that would be control area operators, including any ISO established in the restructuring of power pools. We recognize that some utilities are exploring concepts that do not involve full operational control of the grid. Without in any way prejudging the merits of such arrangements, the following principles do not apply to independent administrators or coordinators that lack operational control. We do not have enough information at this time to offer guidance about such entities, but recognize that they could perform a useful role in a restructured industry.

Because an ISO will be a public utility subject to our jurisdiction,[425] the ISO's operating standards and procedures must be approved by the Commission. In addition, a properly constituted ISO is a means by which public utilities can comply with the Commission's non-discriminatory transmission tariff requirements. The principles for ISOs are:

1. The ISO's governance should be structured in a fair and non-discriminatory manner. The primary purpose of an

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[425]A public utility is any person that owns or operates facilities used for the transmission of electric energy in interstate commerce or the sale of electric energy at wholesale in interstate commerce. An ISO will operate facilities used for the transmission of electric energy in interstate commerce and thus will be subject to the Open Access and OASIS rules.

ISO is to ensure fair and non-discriminatory access to transmission services and ancillary services for all users of the system. As such, an ISO should be independent of any individual market participant or any one class of participants (e.g., transmission owners or end-users). A governance structure that includes fair representation **[31,731]** of all types of users of the system would help ensure that the ISO formulates policies, operates the system, and resolves disputes in a fair and non-discriminatory manner. The ISO's rules of governance, however, should prevent control, and appearance of control, of decision-making by any class of participants.

2. An ISO and its employees should have no financial interest in the economic performance of any power market participant. An ISO should adopt and enforce strict conflict of interest standards. To be truly independent, an ISO cannot be owned by any market participant. We recognize that transmission owners need to be able to hold the ISO accountable in its fiduciary role, but should not be able to dictate day-to-day operational matters. Employees of the ISO should also be financially independent of market participants. We recognize, however, that a short transition period (we believe 6 months would be adequate) will be needed for employees of a newly formed ISO to sever all ties with former transmission owners and to make appropriate arrangements for pension plans, health programs and so on. In addition, an ISO should not undertake any contractual arrangement with generation or transmission owners or transmission users that is not at arm's length. In order to ensure independence, a strict conflict of interest standard should be adopted and enforced.

3. An ISO should provide open access to the transmission system and all services under its control at non-pancaked rates pursuant to a single, unbundled, grid-wide tariff that applies to all eligible users in a non-discriminatory manner. An ISO should be responsible for ensuring that all users have non-discriminatory access to the transmission system and all services under ISO control. The portion of the transmission grid operated by a single ISO should be as large as possible, consistent with the agreement of market participants, and the ISO should schedule all transmission on the portion of the grid it controls. An ISO should have clear tariffs for services that neither favor nor disfavor any user or class of users.

4. An ISO should have the primary responsibility in ensuring short-term reliability of grid operations. Its role in this responsibility should be well-defined and comply with applicable standards set by NERC and the regional reliability council. Reliability and security of the transmission system are critical functions for a system operator. As part of this responsibility an ISO should oversee all maintenance of the transmission facilities under its control, including any day-to-day maintenance contracted to be performed by others. An ISO may also have a role with respect to reliability planning. In any case, the ISO should be responsible for ensuring that services (for all users, including new users) can be provided reliably, and for developing and implementing policies related to curtailment to ensure the on-going reliability and security of the system.

5. An ISO should have control over the operation of interconnected transmission facilities within its region. An

ISO is an operator of a designated set of transmission facilities.

6. An ISO should identify constraints on the system and be able to take operational actions to relieve those constraints within the trading rules established by the governing body. These rules should promote efficient trading. A key function of an ISO will be to accommodate transactions made in a free and competitive market while remaining at arm's length from those transactions. The ISO may need to exercise some level of operational control over generation facilities in order to regulate and balance the power system, especially when transmission constraints limit trading over interfaces in some circumstances. It is important that the ISO's operational control be exercised in accordance with the trading rules established by the governing body. The trading rules should promote efficiency in the marketplace. In addition, we would expect that an ISO would provide, or cause to be provided, the ancillary services described in this Rule.

7. The ISO should have appropriate incentives for efficient management and administration and should procure the services needed for such management and administration in an open competitive market. Management and administration of the ISO should be carried out in an efficient manner. In addition to personnel and administrative functions, an ISO could perform certain operational functions, such as: determination of appropriate system expansions, transmission **[31,732]** maintenance, administering transmission contracts, operation of a settlements system, and operation of an energy auction. The ISO should use competitive procurement, to the extent possible, for all services provided by the ISO that are

needed to operate the system. All procedures and protocols should be publicly available.

8. An ISO's transmission and ancillary services pricing policies should promote the efficient use of and investment in generation, transmission, and consumption. An ISO or an RTG of which the ISO is a member should conduct such studies as may be necessary to identify operational problems or appropriate expansions. Appropriate price signals are essential to achieve efficient investment in generation and transmission and consumption of energy. The pricing policies pursued by the ISO should reflect a number of attributes, including affording non-discriminatory access to services, ensuring cost recovery for transmission owners and those providing ancillary services, ensuring reliability and stability of the system and providing efficient price signals of the costs of using the transmission grid. In particular, the Commission would consider transmission pricing proposals for addressing network congestion that are consistent with our Transmission Pricing Policy Statement. In addition, an ISO should conduct such studies and coordinate with market participants including RTGs, as may be necessary to identify transmission constraints on its system, loop flow impacts between its system and neighboring systems, and other factors that might affect system operation or expansion.

9. An ISO should make transmission system information publicly available on a timely basis via an electronic information network consistent with the Commission's requirements. A free-flow of information between the ISO and market participants is required for an ISO to perform its functions and for market participants to efficiently participate in the market. At a minimum,

information on system operation, conditions, available capacity and constraints, and all contracts or other service arrangements of the ISO should be made publicly available. This information should be made available on an OASIS operated by the ISO.

10. An ISO should develop mechanisms to coordinate with neighboring control areas. An ISO will be required to coordinate power scheduling with other entities operating transmission systems. Such coordination is necessary to ensure provision of transmission services that cross system boundaries and to ensure reliability and stability of the systems. The mechanisms by which ISOs and other transmission operators coordinate can be left to those parties to determine.

11. An ISO should establish an ADR process to resolve disputes in the first instance. An ISO should provide for a voluntary dispute resolution process that allows parties to resolve technical, financial, and other issues without resort to filing complaints at the Commission. We would encourage the ISO to establish rules and procedures to implement alternative dispute resolution processes.

G. *Pro Forma Tariff*

In the NOPR, the Commission stated that --

all utilities use their own systems in two basic ways: to provide themselves point-to-point transmission service that supports coordination sales, and to provide themselves network transmission service that supports the economic dispatch of their own generation units and purchased power

resources (integrating their resources to meet their internal loads).[426]

Accordingly, the Commission proposed two pro forma tariffs in Appendices B and C of the NOPR: one for point-to-point service and one for network service. Our goal was to encourage the development of competitive bulk power markets by ensuring that all participants would be able to secure transmission services on a non-discriminatory basis. We attempted in the NOPR pro forma tariffs to articulate the minimally acceptable terms and conditions of service for point-to-point and network transmission service that were required to ensure non-discriminatory transmission service.[427] We explained that, for the most part, specific pricing provisions were omitted. We asked for **[31,733]** comments on whether these tariffs provided a good basis for defining the minimum acceptable non-price terms and conditions of service.[428]

Subsequently, in a June 28, 1995 order, we encouraged public utilities to file open access transmission tariffs as soon as possible.[429] Tariffs with terms and conditions of service substantively similar to the NOPR pro forma tariffs

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[426]*FERC Statutes and Regulations* ¶32,514 at p. 33,079.

[427]*Id.* at p. 33,092.

[428]On October 27, 1995, the Commission's staff sponsored a technical conference on the pro forma tariffs.

[429]*American Electric Power Service Corporation, et al.*, 71 FERC ¶61,393, modified, 72 FERC ¶61,287 (1995).

would become effective without a refund condition, assuming there were no other concerns, e.g., rate issues. We also indicated that these tariffs would be subject to revision based on the Final Rule.

Unified Pro Forma Tariff

The Commission received many comments on both the point-to-point and network tariffs. Many commenters suggested improvements to the proposed tariffs. Others took issue with how to reconcile various aspects of service under the two tariffs (e.g., cost allocation, service priority, customer rights and obligations). As discussed below, the Commission has attempted to address these concerns in developing tariff requirements for the Final Rule. Importantly, while the Commission has retained point-to-point transmission service and network transmission service as distinct services, the requirements for the two services are now in a single pro forma tariff.[430] The Final Rule pro forma tariff eliminates many of the differences between the two NOPR pro forma tariffs, provides a unified set of definitions, and consolidates certain common requirements such as the obligation to provide ancillary services. The general terms and conditions of transmission service specified in the Final Rule pro forma tariff should be familiar to all utilities, particularly those that have voluntarily filed open access tariffs based on the NOPR pro forma tariffs.

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[430]The Final Rule pro forma tariff is attached as Appendix D.

The Commission believes that the modified, single pro forma tariff, in conjunction with the other requirements, is sufficient to remedy undue discrimination in the provision of transmission services. However, we note that in an accompanying notice of proposed rulemaking in Docket No. RM96-11-000, we are seeking comments on whether a different form of open access tariff -- one based solely on a capacity reservation system -- might better accommodate competitive changes occurring in the industry while ensuring that all wholesale transmission service is provided in a fair and non-discriminatory manner.

We address below the comments received on the NOPR tariff and the specific modifications we have made in the Final Rule pro forma tariff.

1. Tariff Provisions That Affect The Pricing Mechanism

a. Non-Price Terms and Conditions Comments

Utilities For Improved Transition argues that any generic imposition of detailed tariffs on the electric industry will stifle the evolution of the industry. Rather, it asserts, utilities that supply transmission service should be permitted to apply general principles of comparability in their company-specific tariffs, using terms and conditions of service based on their own particular circumstances and those of their customers.

Utility Working Group wants the final rule to allow utilities to depart from the pricing method implicitly contained in the NOPR pro forma tariffs. It argues that the final rule

should recognize that some terms and conditions may not make sense in the context of innovative pricing proposals.

DOE thinks that it is proper to base the tariffs on a familiar and simple pricing method. However, DOE suggests that, in the future, the Commission carefully assess the workability of the contract path model in a competitive bulk power market. DOE suggests that spot or real-time pricing should be considered.

Numerous commenters contend that the NOPR pro forma tariffs are based upon the contract path, embedded cost methodology. According to EEI and other IOU commenters, conforming changes may be needed to various terms and conditions **[31,734]** of the tariffs to implement pricing methodologies that are not based upon contract path. These commenters argue that any flow-based model would necessitate different non-price terms and conditions. The commenters generally recognize the technical difficulties of implementing a flow-based model.[431] These commenters assert that the NOPR pro forma tariffs, as written, are not independent of pricing.

EGA criticizes the assumption underlying the contract path approach, i.e., that the capacities of individual transmission paths can be determined independently and made available to third parties. EGA notes that, in light of the competitive implications associated with transmission pricing, some utilities may propose other non-price terms and

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[431] Additional comments concerning transition to flow-based pricing are summarized in Section IV.A.6.

conditions suitable for other pricing methods, including power-flow-based tariffs. EGA expresses concern that the pro forma tariffs will be the only type of tariff allowed. EGA believes that the Commission should follow its transmission pricing policy guidelines and not impose a special burden on parties proposing tariffs that differ from the final rule pro forma tariffs, including non-price terms that support alternative pricing methods.

Some commenters also interpret the lack of reference to opportunity cost and incremental cost in the NOPR pro forma tariffs as a rejection of their use.[432]

Commission Conclusion

We agree that non-price terms and conditions cannot be designed independent of pricing and cost recovery. As discussed in detail below, the Final Rule pro forma tariff is intended to initiate open access, with non-price terms and conditions based on the contract path model of power flows and embedded cost ratemaking. It is designed based on the practices and procedures currently used by virtually all public utilities and complements the large number of tariffs already filed with the Commission. The Final Rule pro forma tariff is not intended to signal a preference for contract path/embedded cost pricing for the future. We recognize that the industry, in response to changes in institutions, competitive pressure, and technological innovations, is evolving rapidly. For example, various forms of flow-based pricing are beginning to be

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[432]*E.g.*, BPA, Utilities For Improved Transition, PG&E, Duke.

considered in conjunction with electronic transmission information systems. We seek to encourage this process and will in the future entertain non- discriminatory tariff innovations to accommodate new pricing proposals.[433]

In response to various comments, we are revising certain non-price terms and conditions where suggested changes either improve the tariff services or reconcile tariff inconsistencies. The nature of these tariff revisions does not appear to have serious cost consequences. The mandated changes are generally compatible with the rate proposals already filed by many public utilities. As discussed in Section IV.H., those utilities will not be required to file corresponding rate changes due to our mandated tariff changes to non-price terms and conditions, although they will be permitted to do so.

The Final Rule pro forma tariff includes specific terms and conditions rather than general principles. By initially requiring a standardized tariff,[434] we intend to foster broad access across multiple systems under standardized terms and conditions. However, in response to concerns raised by certain commenters, the tariff provides for certain deviations where it can be demonstrated that unique practices in a geographic region require modifications to the Final Rule pro

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[433]We further clarify that, contrary to some commenters' interpretation, the Final Rule pro forma tariff is in no way a rejection of opportunity or incremental cost pricing.

[434]As noted in Section IV.H., public utilities may propose variations that are consistent with or superior to the terms and conditions in the Final Rule pro forma tariff.

forma tariff provisions. Accordingly, where applicable, the tariff permits the use of alternative non-price terms or conditions that are reasonable, generally accepted in the region, and consistently adhered to by the transmission provider.

Finally, we will allow utilities to propose a single cost allocation method for network and point-to-point transmission services. These principles, as well as other **[31,735]** modifications and clarifications to the NOPR pro forma tariffs, are discussed in detail below.

b. Load Ratio Sharing Allocation Mechanism for Network Service

Comments

Some commenters believe that load ratio cost allocation is appropriate for network service.[435] Other commenters argue that load ratio cost allocation is inappropriate, but disagree on the alternative. They offer a variety of other cost allocation and pricing methods.

The most frequent comment is that network and point-to-point services should be priced on the same basis. Florida Power Corp wants network contract demand to be offered and priced on a 12 CP basis.[436] ConEd and Duke argue that their

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[435]*E.g.*, PSNM, WP&L.

[436]Florida Power Corp's contract demand proposal would allow a network customer to nominate less than its full load for transmission service.

systems are built and designed to meet a single peak; therefore, they contend that network service costs should be allocated with a load ratio calculation based on annual system peak rather than 12 CP. PSE&G claims that load ratio cost allocation works only if the customer has its own generation. Many commenters propose that "behind the meter" generation and load be eliminated from the network load ratio calculation.[437]

CINergy notes that the transmission provider's monthly load ratio calculation includes its long-term off-system firm service. It proposes that off-system sales be eliminated from the load ratio calculation to enable the transmission provider to offer discounts on long-term service. Alternatively, CINergy proposes that the revenues from these long-term off-system sales be shared with network customers based on their load ratio.

Atlantic City and Allegheny contend that cost allocation for network service should also reflect customers' relative energy use (i.e., not just customers' coincident demand). Consequently, these commenters propose that cost allocation consider the network customer's actual load factor. Allegheny also proposes adding a minimum revenue provision to the load ratio method to recognize cost responsibility for non-peak use. Allegheny further proposes to include an increasing return on equity as available transmission capacity decreases. EEI proposes that cost allocation be based on a customer's non-coincident peak demand.

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[437] *E.g.*, Cajun, NRECA.

Lower Colorado River Authority proposes using load flow studies to determine planned use during the system peak with MW-mile billing units. It believes that this pricing method should be used for all transmission service to ensure comparable transmission pricing. Oklahoma G&E wants cost allocation to be based on the impacted MW-mile method, or alternatively, to determine embedded cost by voltage level. Centerior proposes the use of actual transfer capability instead of contract path capability in determining cost responsibility.

Orange & Rockland recommends some form of a "poolco" approach using locational marginal cost pricing. DOE also recommends using location-specific spot pricing (a form of marginal cost) for operating and congestion costs.

Public Generating Pool believes that load ratio share pricing is unworkable in the Pacific Northwest, in part because generation is generally located outside of the control area directly served by parties in the Northwest, and in part because BPA, which does not have a typical service territory, dominates the regional transmission market. Seattle states that cost allocation based solely on demand is inappropriate for systems that consist predominantly of hydro generation.[438]

AEC & SMEPA and NRECA are concerned about pancaked rates for network service that is provided to load served by more than one network tariff. Other commenters

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[438]Additional comments concerning the Pacific Northwest are summarized in Section IV.K.

advocate use of some form of regional pricing.[439] American Wind proposes the use of a complex seasonal calculation, which appears to benefit wind energy. NY Com and Missouri-Kansas Industrials also express a preference for seasonal pricing models.

[31,736]
Commission Conclusion

We conclude that the load ratio allocation method of pricing network service continues to be reasonable for purposes of initiating open access transmission. Network service permits a transmission customer to integrate and economically dispatch its resources to serve its load in a manner comparable to the way that the transmission provider uses the transmission system to integrate its generating resources to serve its native load. Because network service is load based, it is reasonable to allocate costs on the basis of load for purposes of pricing network service. This method is familiar to all utilities, is based on readily available data, and will quickly advance the industry on the path to non-discrimination. We are reaffirming the use of a twelve monthly coincident peak (12 CP) allocation method because we believe the majority of utilities plan their systems to meet their twelve monthly peaks. Utilities that plan their systems to meet an annual system peak (e.g., ConEd and Duke) are free to file another method if they demonstrate that it reflects their transmission system planning. Moreover, we recognize that alternative allocation proposals may have merit and welcome

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[439] *E.g.*, OH Coops, Municipal Energy Agency Nebraska, UT Com.

their submittal by utilities in future rate applications. They will be evaluated on a case-by-case basis and decided on their merits.

As to the concerns raised by AEC & SMEPA and NRECA about pancaked rates for network service provided to load served by more than one network service provider, we have stated that if a customer wishes to exclude a particular load at discrete points of delivery from its load ratio share of the allocated cost of the transmission provider's integrated system, it may do so.[440] Customers that elect to do so, however, must seek alternative transmission service for any such load that has not been designated as network load for network service. This option is also available to customers with load served by "behind the meter" generation that seek to eliminate the load from their network load ratio calculation.

As noted, the most frequent comment is that the network and point-to-point services should be priced on a similar basis. This concern is addressed in the next section.

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[pp. 31,743 - 31,753]

[31,743]

g. Ceiling Rate for Non-Firm Point-to-Point Service

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[440] *Florida Municipal Power Agency v. Florida Power & Light Company*, 74 FERC ¶61,006 (1996), reh'g pending.

Commenters generally support a ceiling rate for non-firm transmission service, capped at the firm rate.[453] Others request clarification as to whether the point-to-point tariff rates are fixed or are ceiling rates. Central Illinois Public Service's major concern is that, if the rates are fixed, the tariffs may result in higher prices for capacity and energy than those currently allowed for bundled service.

NYSEG argues that unequal pricing is a natural phenomenon of the open marketplace and requests assurance that offering transmission service at prices below a cost-based ceiling rate will not expose a transmission provider to claims of undue discrimination.

AEC & SMEPA opposes using the firm rate as the cap for non-firm transmission service. It states that, given the substantially lower quality of non-firm service (with no obligation to plan for such service), no cost-of-service principle justifies charging rates for non-firm service as high as the rate for firm service.

EGA and NRECA state that any discounts from the maximum firm rate must be uniform, transparent, readily understood, and posted on a RIN. According to CCEM and NRECA, the transmitting utility must have nondiscriminatory discount practices and must contemporaneously offer discounts to transmission customers at the same time and on the same basis as discounts for internal sales operations or affiliates. Commission Conclusion

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[453] *E.g.*, Duke, SCE&G, AEP, FPL.

We believe that it is important to continue to allow pricing flexibility. In accordance with the Commission's current policies, the rate for non-firm point-to-point transmission service may reflect opportunity costs. Any provisions for opportunity cost pricing for non-firm service must meet the requirements already discussed. If a utility chooses to adopt opportunity cost pricing, the non-firm rate is effectively capped by the availability of firm service and is not subject to a separately-stated price cap. If a utility chooses not to adopt opportunity cost pricing, the non-firm rate is capped at the firm rate. We also wish to ensure that non-firm transmission service is priced in a nondiscriminatory fashion. Accordingly, if a transmission provider offers a rate discount to its affiliate, or if the transmission provider attributes a discounted rate to its own transactions, the same discounted rate must also be offered at the same time to non-affiliates on the same **[31,744]** transmission path and on all unconstrained transmission paths. We will further require that any affiliate discounts from the maximum firm rate must be transparent, readily understandable, and posted on the transmission provider's OASIS in advance so that all eligible customers have an equal opportunity to purchase non-firm transmission at the discounted rate.[454] In addition, discounts offered to non-affiliates must be on a basis that is not unduly discriminatory and must be reported on the OASIS within 24 hours of when

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[454]The same requirements will apply to discounts from firm transmission service. Similarly, if a transmission provider offers an affiliate a discount for ancillary services, or attributes a discounted ancillary service rate to its own transactions, it must offer at the same time the same discounted rate to all eligible customers. Discounted ancillary services rates must be posted on the OASIS pursuant to new Part 37 of the Commission's regulations.

available transmission capability (ATC) is adjusted in response to the transaction. As discussed in the RIN section, information, including the price for all non-firm transaction discounts, must be posted on the OASIS to ensure comparability.

2. Priority For Obtaining Service

The term "priority" is used in the comments in several senses. The intent of the comment depends on which kind of "priority" is intended. In general, there are comments about the order in which parties can obtain new service, which we call "reservation priority," and there are comments about the order in which parties lose service they already have, which we call "curtailment priority." Commenters may establish different reservation priorities for various services, such as network, off-system sales, firm, ability to reserve a portion of new transmission capacity to be constructed, and so on. Curtailment priorities also differ with the type of service. However, many commenters assert that certain parties should or should not have "priority" without distinguishing the kind of priority or type of service for which priority is intended.

a. Reservation Priority for Existing Firm Service Customers

Many IOUs, state commissions, and cooperatives strongly believe that native load should have priority to reserve transmission capacity under the tariffs.

EEI suggests that existing and future allocations of transmission capacity must be based on proper transmission pricing or, in its absence, priority of service. According to EEI, retail and existing wholesale requirements service should

have the highest priority for use of transmission capacity, followed by long-term point-to-point service. Dayton P&L supports a continued preference for native load growth because native load customers have borne the majority of the costs of the transmission system. Detroit Edison, EEI, and Florida Power Corp claim that, because native load and network customers pay higher rates during all hours, such customers should have higher priority for service requests than others requesting transmission service. These commenters also claim that the transmission provider should be able to reserve firm capacity for native load and network service customers.

Similarly, NARUC wants wholesale and retail native load customers to be held harmless from functional unbundling of wholesale transmission services. Because these customers have borne the vast majority of the costs of the utility's transmission facilities, NARUC argues that priority of service, quality of service, and allocation of joint and common costs to native load customers should not be affected by the transition to an open access transmission regime.

PA Com does not share the Commission's concern that a transmission provider may discriminate against a third party transmission customer vis-a-vis native load. It finds nothing impermissible in this sort of discrimination, arguing that the interconnected system was financed by, designed for, and built to serve native load.

NRECA explains that most transmission customers that seek network service will already be receiving similar service (albeit in a bundled form) from their transmission providers. It argues that these customers should receive the

same priority of service as the transmission provider's native load customers for as long as they continue to take network service, whether under a current bundled wholesale **[31,745]** supply contract, a private transmission contract, or a network tariff.[455]

East Kentucky requests that the final rule clarify that member distribution cooperatives of G&Ts will have priority over third parties in the use of the G&T's existing transmission facilities. TVA comments that native load customers and emergency service to neighboring systems should have a higher service priority than transmission services sold to third parties (where an alternative power supply is available to the third party).

Commission Conclusion

We reiterate that we are not requiring the transmission provider to unbundle transmission service to its retail native load nor are we requiring that bundled retail service be taken under the terms of the Final Rule pro forma tariff. However, the amount of transmission capacity available to wholesale and unbundled retail customers under the Final Rule pro forma tariff is clearly affected by the amount of transmission capacity that the transmission provider reserves for the use of its native load customers and the future load growth of those customers. The transmission provider may reserve in its calculation of ATC transmission capacity necessary to accommodate native load growth reasonably forecasted in its planning horizon. However, the transmission provider is

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[455]See also American Forest & Paper, AMP-Ohio.

obligated to provide transmission service to others under the Final Rule pro forma tariff out of capacity reserved for native load growth up to the time the capacity is actually needed for such future needs. Furthermore, as we explained previously, while existing wholesale customers do not have any ownership-like rights to the capacity they used during the term of their contract, they will have a right of first refusal to that capacity after the expiration of their contracts or when their contracts become subject to renewal or rollover.[456]

b. Reservation Priority for Firm Point-to-Point and Network Service

A number of commenters argue that all firm service should not be treated equally. These commenters argue that the price of the service should determine the priority that the service receives. A large number of IOUs and potential network customers (existing requirements customers) argue that in light of the pricing implicit in the NOPR, (i.e., 12 CP for network versus annual system peak for point-to-point) network service should have priority over point-to-point service (because, all other things being equal, the price for network service will be higher).

BG&E believes that a customer receiving service priority equal to native load and network customers should pay comparable rates. Thus, BG&E argues that either flexible firm point-to-point service should be priced the same as network service, or point-to-point service should have a lesser

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[456]See discussion in Section IV.A.5.

priority than native load and network service customers if point-to-point service is priced lower than network service.

DE Muni believes that native load and network customers must have priority access to interfaces (particularly where they are constrained) after system reliability concerns have been satisfied. The same argument is advanced by commenters concerning long-term service versus short-term service. Public Generating Pool argues that long-term service should always have priority over short-term service because long-term customers contribute more towards fixed-cost recovery than do short-term customers.

Cajun objects to having its service and service to its customers, which it characterizes as network service, receive the same priority as firm point-to-point service customers who take service for periods as short as one hour. Cajun points out that it, as well as other network and native load customers, have been paying and will be paying for the transmission facilities in place to serve their needs for many years. According to Cajun, the transient firm point-to-point customer should not have equal standing. Cajun suggests, however, that a long-term firm point-to-point customer taking service for ten years or more should have service priority equal to native load and network service customers.

SC Public Service Authority argues that the availability of short-term firm service with a priority equal to long-term service would provide a means for short-term **[31746]** customers to obtain the advantages of long-term firm service at a much lower total cost. As a result, it argues that a few point-to-point customers would opt for long-term firm

service, and the burden of the residual costs of the transmission system would fall on network customers.

EEI claims that priority for point-to-point service should be on a continuum of firmness, with reservation (as well as curtailment) priority based upon duration of service and specific negotiated terms. EEI proposes that the point-to-point tariff be modified to provide a first-tier category of flexible point-to- point transmission service that is comparable in priority, price, length, and terms of service to network service. EEI believes that this modification will resolve the problems that are associated with establishing priorities between network service and point-to-point service if the Commission retains different CP cost allocation methods for each service.

On the other hand, CCEM, a group of power marketers, supports the concept that all firm service should be treated equally, regardless of the term or the nature of service.

Commission Conclusion

An essential element of non-discriminatory transmission access is the right of transmission customers to reserve and purchase transmission service that is of the same quality as that used by the transmission provider in serving its wholesale requirements customers and retail load. Thus, we reject the proposal of some commenters that transmission providers need not provide firm point-to-point service that is of the same "firmness" as the transmission provider's service to native load. However, the fact that both network service and point-to-point service are provided on an equally firm

basis does not mean that both types of service must be priced or reserved in the same manner.

The comments about reservation priorities for firm services boil down to two concerns. First, due to the differences in pricing firm point-to-point service and network service implicit in the NOPR (i.e., twelve-monthly CP pricing for network versus annual system peak for point-to-point), some commenters believe that network service should have priority over point-to-point service. Second, some commenters maintain that according firm, short-term point-to-point service a priority equal to long-term service provides a means for short-term customers to avoid making a fair contribution to the long-term costs of the system.

With respect to the first concern, we have eliminated the differences in pricing by permitting utilities to adopt point-to-point reservations as the customer load. As discussed above, for purposes of the Final Rule pro forma tariff, utilities are free to propose a single cost allocation method for the two services.

The second area of concern arises because of the first-come first-served reservation priority in the NOPR point-to-point tariff. The Commission recognizes that the tariffs, as proposed in the NOPR, provide the opportunity for a customer to reserve certain valuable rights (e.g., the right to short-term firm service during peak periods) while avoiding in part the long-term costs of the system (perhaps by relying on non-firm service during lengthy off-peak periods when there is a substantially reduced chance of interruption). However, the Commission has a countervailing concern that the transmission provider should not be able to withhold

valuable transmission capacity from potential customers if that capacity is not being used by those who are paying for the long-term costs of the system.

Accordingly, the Final Rule pro forma tariff provides a mechanism to address this concern while safeguarding the rights of potential customers to obtain access to unused capacity. The tariff provides that reservations for short-term firm point-to-point service (less than one year) will be conditional until one day before the commencement of daily service, one week before the commencement of weekly service, and one month before the commencement of monthly service. These conditional reservations may be displaced by competing requests for longer-term firm point-to-point service. For example, a reservation for daily firm point-to-point service could be displaced by a request for weekly firm point-to-point service during an overlapping period. Before the applicable reservation deadline, a holder of a conditional firm point-to-point reservation would have the right of first refusal to match any longer-term firm point-to-point reservation before being displaced. After the deadline, the reservation becomes **[31,747]** unconditional, and the service would be entitled to the same priorities as any long-term point-to-point or network firm service.[457]

The Final Rule pro forma tariff does not propose point-to-point or network service with various degrees of firmness beyond the simple categories of firm and non-firm. When a customer requests firm transmission service,

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[457]The service itself, as opposed to reservations, is subject to the curtailment provisions discussed below.

reservation priorities are established based first on availability, and in the event the system is constrained, based on duration of the underlying firm service request; customers may choose the "firmness" of service they want by electing to take non-firm service, or by reserving and paying for firm service. We have not included any degrees of firmness in the Final Rule pro forma tariff because having intermediate categories of firmness under point-to-point or network service would, we believe, unnecessarily complicate the priority system. However, utilities are free to propose and fully support different reservation priority provisions for firm service in subsequent rate filings as long as those provisions are not unduly discriminatory, fully comply with the principles of comparability, and are priced appropriately.

c. Reservation Priorities for Non-Firm Service

IOUs, state commissions, and potential network customers tend to support the service reservation priorities for non-firm service set forth in the NOPR pro forma tariffs (i.e., transmission service by network customers for economy purchases to serve network load has a higher priority than non-firm point-to-point service, which has a higher priority than a firm point-to-point customer using transmission service at secondary points of receipt and delivery). However, because network customers pay a higher rate than point-to-point customers, these commenters argue that network customers should be permitted to use their off-peak load ratio share of the transmission system to make off-system sales. Many commenters argue that point-to-point customers can use their secondary service for both purchases and sales; thus, they believe it is discriminatory to limit network customers to purchases at secondary points.

Commenters that are opposed to the service reservation priority scheme in the NOPR pro forma tariffs argue that transmission providers will discriminate against third party users in favor of their native load economy purchases. These commenters argue that all non-firm service should have equal priority.

Other commenters, such as CINergy, would base priority on the duration of service. CINergy claims that this method would eliminate what it claims is an advantage (over network) given in the NOPR to point-to-point service in making short-term purchases. TVA notes that it establishes priority for non-firm service based on duration of service requested, with customers in each service category receiving priorities based on the rate they wish to pay.

Some commenters believe that the transmission price should affect the priority of customers to obtain non-firm transmission capacity.[458] However, other commenters argue that this seems to be precluded by the NOPR pro forma tariffs' service priority provisions.

Although PSE&G believes that the NOPR pro forma tariffs suggest a first-come, first-served allocation method for capacity in excess of that needed for firm transmission service, it proposes a fixed period of time for all potential users to submit bids for service (e.g., one week prior for monthly service), allowing the bid price to determine priority (i.e., the higher bid prices receive service priority over lower bid prices). According to PSE&G, customers could bid an "up

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[458] *E.g.*, Duke, Orange & Rockland.

to" rate subject to a price floor, with all revenues flowed back to firm service customers. TVA also advocates departing from the first-come, first-served approach for allocating some uses of the transmission system, claiming that price is an effective means to establish priority for non-firm and short-term firm services.

Utility Wind Interest Group requests that non-firm service used for transmitting renewable resources be given a higher priority than non-firm service used **[31,748]** for transmitting conventional resources because renewable resources cannot store their fuel supply. Commission Conclusion

We continue to believe that network economy purchases should have a reservation priority over non-firm point-to-point and secondary point-to-point uses of the transmission system. Network transmission customers are obliged to pay all of the costs of the transmission system without regard to the resources from which energy is scheduled. Therefore, it is appropriate that the transmission associated with a network customer's economy purchases (i.e., transmission that is used to substitute one resource for another on an as-available basis) enjoys a higher priority than non-firm point-to-point transmission service.

Regarding the reservation priority for non-firm service under point-to-point service, we will adopt a reservation priority based upon duration of non-firm service, with price acting as a tie-breaker for competing service requests of an equal duration. If there is insufficient transmission capacity to accommodate all non-firm transmission requests, the reservation of longer duration should displace the shorter. For

example, a reservation for a month of non-firm service will displace a reservation for a week of non-firm service. Also, a reservation for a week will displace a reservation for a day, which will displace a reservation for an hour of non-firm service. If a customer requests non-firm and later another customer requests longer-term non-firm service before either term of service begins, the first customer to request service has the right of first refusal to change its request to the longer term of service. A firm point-to-point customer's use of transmission service at secondary points of receipt and delivery will continue to have the lowest reservation priority.

3. Curtailment Provisions

a. Pro-Rata Curtailment Provisions

A large number of IOUs that are control area operators argue for discretion to curtail the transaction that most effectively relieves the constraint, in lieu of mandatory pro-rata curtailments, which they argue are inappropriate and not cost effective.

Other commenters that do not support pro-rata curtailment argue that preference should be given to native load or existing customers because these customers have paid the majority of the costs of the transmission system. A large number of customers note that their existing contracts contain "enhanced" curtailment priorities (i.e., service to others will be curtailed before service to customers with such curtailment

priority) due to the large capital outlays made by them in connection with their service.[459]

Public Generating Pool believes that the proposed curtailment provisions may not be flexible enough for transactions in the Northwest. It argues that hydro spill should be avoided, and suggests that transactions from federal and/or non-federal hydroelectric generation facilities should not be curtailed pro rata with other transactions that do not rely on such facilities. Public Generating Pool urges that regional agreements (e.g., regional transmission group agreements) that would achieve this goal should be given deference.

Other commenters support pro-rata curtailments for firm service.[460] PSNM states that this has been its operating practice in the past, and PSNM expects to continue such an approach in the future.

Power marketer commenters generally support the pro-rata curtailment adding that a standardized curtailment priority applied nationally would provide greater open access and eliminate discriminatory curtailments.

Commenting on a related subject, EEI maintains that the network tariff provision for termination of service in the event a customer fails to curtail load[461] may not be realistic for

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[459]*E.g.*, TANC, Turlock, SMUD.

[460]*E.g.*, PSNM and Nebraska Public Power District.

[461]Proposed Pro Forma Network tariff section 9.7 - System Reliability.

service to a Transmission Dependent Utility. EEI suggests that the Commission supplement this provision with a substantial penalty provision, coupled with an indemnification requirement.

[31,749]
Commission Conclusion

It was not our intent in the NOPR to require all transactions to be curtailed on a pro-rata basis regardless of whether the transaction relieves a constraint. We intended to permit curtailments of transactions that substantially relieve a constraint.[462] We intended and continue to believe that curtailment on a pro-rata basis is appropriate for curtailing the transactions that substantially relieve the constraint. In order to allay the concerns of the commenters addressing this issue,

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[462]The Final Rule pro forma tariff contains language allowing the transmission provider the discretion to interrupt firm transmission service in an emergency or other unforeseen condition in a manner suggested by these commenters. Section 11.6, Curtailment of Firm Service, of the Final Rule pro forma tariff provides:

However, the Transmission Provider reserves the right to interrupt, in whole or in part, firm Transmission Service provided under this Tariff when, in the Transmission Provider's sole discretion, an emergency or other unforeseen condition impairs or degrades the reliability of its transmission system.

The reference to curtailments being allocated on a proportional (pro rata) basis addresses situations where multiple transactions could be curtailed to relieve a constraint.

we are clarifying the curtailment provision of the tariff to explicitly allow the transmission provider discretion to curtail the services, whether firm or non-firm, that substantially relieve the constraint. Of course, any curtailment must be made on a non-discriminatory basis, including curtailment of the transmission provider's own use of the transmission system. Customers that believe the curtailment policy is administered unfairly may file a section 206 complaint at the Commission.

Concerning the request of certain Pacific Northwest commenters, we would consider granting deference to an alternative curtailment method to avoid hydro spill if such a regional practice is generally accepted and adhered to across the region, as discussed further in Section IV.K.

Finally, we agree with EEI's observation that terminating network service under the tariff to a transmission dependent utility that fails to curtail load as required may not be appropriate. As a result, we clarify that under network and point-to-point service, the transmission provider may propose a rate treatment (penalty provision) to apply in the event a customer fails to curtail load as required under the Final Rule pro forma tariff. Such proposals will be evaluated on a case-by-case basis on compliance.

b. Curtailment Provisions for Non-Firm Service

A number of commenters seek clarification of the curtailment provision for non-firm service under the two tariffs. They note that economy purchases by the network customer are accorded a higher curtailment priority than non-firm service under the point-to-point tariff. However, under

the point-to-point tariff there is no acknowledgement of this higher priority for network service. Curtailments for non-firm transmission service under the point-to-point tariff are simply based upon duration of service, without reference to a higher priority for network economy purchases.

A number of commenters, including Industrial Energy Applications, suggest that a price-based curtailment queue for non-firm transmission will facilitate economy energy deals in highly competitive wholesale power supply markets and allow the parties to directly address delivery risk through the pricing mechanism.

Blue Ridge argues that the final rule should provide equal curtailment priority for all types of non-firm transmission service. Utilities For Improved Transition argues that network customers should be able to transmit non-firm power imports under the network tariff with the same curtailment priority that is assigned to all other firm network uses of the transmission system.

A number of commenters note that the tariffs allow non-firm service to be interrupted only for emergency or reliability reasons or to provide firm service. These commenters contend that, under this requirement, curtailment of non-firm service is unlikely.[463] As a result, they believe that non-firm service is elevated to firm service. To remedy this situation, these commenters argue that transmission

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[463] *E.g.*, Florida Power & Light Company, Southern California Edison Company.

providers should have the ability to **[31,750]** curtail non-firm service for any economic reason.

Commission Conclusion

We have clarified in the Final Rule pro forma tariff that a network customer's economy purchases have a higher curtailment priority than non-firm point-to-point transmission service.

A higher curtailment priority should be provided to network economy energy purchases for the reasons stated in AES Power, Inc..[464] In that case, we recognized that the network transmission customer has already "paid" for the transmission of its economy purchases (i.e., transmission that is used to substitute one resource for another on an as available basis) through its payment of a load ratio share of the system.

Many commenters oppose the point-to-point service provision allowing non-firm service to be interrupted only for emergency or reliability reasons or to provide firm service. Upon further consideration, we agree that this provision is too narrow. Accordingly, the Final Rule pro forma tariff is revised to allow the transmission provider to curtail non-firm service for reliability reasons or economic reasons (i.e., in order to accommodate (1) a request for firm transmission service, (2) a request for non-firm service of greater duration, (3) a request for non-firm transmission service of equal

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[464]69 FERC ¶61,145 at p. 62,300 (1994) (proposed order), 74 FERC ¶61,220 (1996) (final order).

duration with a higher price, or (4) transmission service for economy purchases by network customers from non-designated resources.). However, all curtailments must continue to be made on a non-discriminatory basis including curtailments of the transmission provider's own non-firm uses of the transmission system under the tariff. A firm point-to-point customer's use of transmission service at secondary points of receipt and delivery will continue to have the lowest curtailment priority.

4. Specific Tariff Provisions

a. Network and Point-to-Point Customers' Uses of the System

Generally, transmission providers argue that the tariffs give too much flexibility to customers, while transmission customers argue that even more flexibility is required. The arguments are generally tied to pricing rather than technical problems with providing any level of service.

A common transmission provider argument is that the proposed firm point-to-point tariff provides a premium service comparable to network service, but at a lower rate. It has been suggested that either the flexibility to use non-firm service at secondary points of receipt and/or delivery at no additional charge under the point-to-point tariff be eliminated or that point-to-point customers should pay a premium price for such flexibility.[465] Transmission providers generally argue that flexible point-to-point service puts the transmission owner

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[465] *E.g.*, EEI, Utility Working Group, SoCal Edison.

and the network customer at a competitive disadvantage. They assert that the point-to-point customer is able to use non-firm transmission to reach secondary receipt and delivery points for both sales and purchases, but the network customer may use only non-firm transmission to reach secondary points for purchases. Thus, they argue, the flexible point-to-point users can sell non-firm power with a small or even no transmission component (because the underlying transmission is effectively free). Electric Consumers Alliance and Cajun believe that the owner and network customer competing for that sale should not be charged for the identical transaction. Absent a change to the point-to-point tariff, a number of transmission providers and state commissions (including Midwest Commissions) argue that to provide balance to the tariffs, the network tariff should permit the network customers to have non-firm transmission to secondary receipt and delivery points at no additional charge for both purchases and sales within its load-ratio transmission entitlement. Utilities For Improved Transition refers to this proposed network tariff modification as "headroom."

CCEM opposes the headroom concept, arguing that "free" use of capacity will give transmission providers an unfair competitive advantage. CCEM also cites Order No. 636 in support of its position.

Conversely, a number of customer groups believe the point-to-point tariff **[31,751]** should be made more flexible by broadly defining the concept of points of receipt and delivery. They argue that all points of connection between the transmitting utility and the purchasing utility should be treated as a single point of delivery (POD) or point of receipt

(POR).[466] In this manner, a customer would not have to pay for every point of receipt or point of delivery, but could select a contract demand level of service. The customer could then use the service at multiple points without incurring separate reservation charges for each point.

A number of commenters contend that the Commission should not force specific tariffs on public utilities in the Pacific Northwest due to their unique status.[467] In particular, NWRTA recommends that the final rule recognize that the Pacific Northwest's integrated transmission system, including large components owned by non-public utilities, was constructed to support a unique region-wide hydroelectric-dependent generating system. NWRTA recommends that the final rule be sufficiently flexible to accommodate these unique characteristics without prejudicing the interests of users or providers of transmission services.

Similarly, Public Generating Pool states that the NOPR pro forma network tariff departs from the status quo arrangements in the Northwest and is generally unworkable because generation is usually remote from the control area serving the network load and because BPA, which does not have a typical service territory, dominates the regional transmission market. Public Generating Pool suggests that the Commission require, and the region develop, a "generation integration" transmission tariff that would offer network-type

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[466] *E.g.*, Arkansas Cities, NRECA.

[467] *E.g.*, Public Power Council, Washington Water Power, NWRTA.

service to a source or sources of generation unbundled from the "network services" designed to integrate load. Similar contract demand network tariffs have already been proposed by some IOUs.

Commission Conclusion

We will not allow network customers to make off-system sales within the load-ratio transmission entitlement at no additional charge. Commenters have raised no new arguments to persuade us to do so, The primary purpose of network service is to integrate resources to serve loads. Use of transmission by network customers for non-firm economy purchases, which are used to displace firm network resources, must be accorded a higher priority than non-firm point-to-point service and secondary point-to-point service under the tariff. Off-system sales transactions. which are sales other than those to serve a network customer's native load, must be made using point-to-point service. They can be made on either a firm or non-firm basis.

A large number of transmission providers support the "headroom" concept, arguing that without it the flexible point-to-point service puts them at a competitive disadvantage. This would be true if a utility serving load were required to use network service exclusively, However, we do not require any utility to take network service to integrate resources and loads. If any transmission user (including the public utility) prefers to take flexible point-to-point service,[468] they are free to do so. Any point-to-point customer may take advantage of the secondary, non-firm flexibility provided under point-to-point service equally, on an as-available basis.

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[468] *See Florida Municipal Power Agency v. Florida Power & Light Company*, 74 FERC ¶61,006 at p. 61,013 and n. 70 (1996).

b. Minimum and Maximum Service Periods

Commenters raise issues regarding the minimum term of one hour for firm point-to-point service. Their concerns center on price and priority. Transmission providers point out that their native load customers pay the fixed cost of the transmission system every hour of the year. They argue that comparability is not achieved by permitting others to have service for one hour with equal priority to native load and other long-term customers. Others worry that the one-hour minimum term will: (1) Promote the selective use of the transmission system: (2) impair the ability of a utility to plan its system; and (3) adversely impact longer term transactions.

Tallahassee and KY Com are concerned that one-hour firm service may encourage **[31,752]** speculative advance requests for service during the system peak day (Cajun refers to this as cream skimming). These commenters express concern that such requests could displace other valid transactions or constrain a corridor or interface to the detriment of network service or native load customers, Tallahassee proposes a one-day minimum term for firm service.[469]

East Kentucky is concerned that users of the transmission system could, under the Commission's proposed open-access rule, purchase short-term firm service during peak months in lieu of annual firm service to reduce expenses associated with the purchase of firm transmission service. By buying short-term firm service only during the peak months,

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[469]See also VEPCO, CSW, NYSEG, WP&L.

an entity can significantly reduce its transmission expenses by purchasing non-firm service during off-peak months when the available transmission capacity far exceeds the demand on the transmission system. For this reason, some commenters request that short-term firm service be priced to generate revenues over the peak months equal to the charge for annual firm service.

Duke argues that, because all curtailments are equal, the addition of each one hour firm transaction will lower the reliability profile of native load customers and other customers with long-term commitments. It suggests that different classes of services be established that offer transmission customers the flexibility to obtain an intermediate level of transmission service (between native load firm and non-firm) for transactions of shorter duration.

On the other hand, some TDUs and power marketers support the one-hour minimum term. TAPS argues that transmission providers should not be permitted to restrict the availability of hourly, daily or weekly transmission service at reasonable prices, as some transmission providers have proposed in open access cases. Brazos supports a minimum duration of service equal to the minimum scheduling period of the transmission owner. Turning to the maximum term of service, Chugach objects to the imprecise requirement that transmission service be offered for a term equal to the life of a particular generation resource. Chugach, joined by VEPCO, suggests that the Commission require transmitting utilities to offer five-year terms (with longer contract terms by negotiated agreement).

Although BPA supports eliminating arbitrary term limitations and facilitating long-term resource commitments, it is concerned that the Commission's failure to specify a maximum term for firm transmission service (particularly where no specific resource is being wheeled) requires transmitting utilities to effectively sell off their transmission capacity to third parties. In BPA's view. such a requirement goes well beyond the intent of the Energy Policy Act.

PSE&G argues that the term limit for firm transmission service should be consistent with the transmission provider's planning horizon (e.g., for PSE&G, 10 years), which will ensure comparability of firm third party customers with native load. According to ConEd, failure to specify a maximum term for service creates uncertainty for planning purposes. PECO believes that utilities should have the right to limit the term of service to either: (1) The expected useful life of facilities used in providing service; or (2) the term of permits and land rights needed for those facilities.

Commission Conclusion

We will adopt a one-day minimum term for firm point-to-point service. The one-day minimum term for firm point-to-point service, along with modifications to the procedures for requesting firm point-to-point service, will moot a number of reliability concerns and allegations about possible "cream-skimming." As discussed supra, firm service requests with longer durations of service will have bumping rights over shorter term firm service requests. Also, the one day minimum will not disadvantage anyone because the transmission provider will be subject to the same one-day

term for its firm point-to-point uses of the transmission system. Because of the longer-term nature of network service, it will be subject to a one-year minimum term.

We will not specify a maximum term for either point-to-point or network transmission service. However, we recognize the concerns raised by commenters that a **[31,753]** commitment of uncertain duration makes planning difficult. Therefore, we will modify the tariff to require that an application for transmission service specify the length of service being requested. This will provide the transmission provider with the certainty it needs for planning, and the transmission customer with the flexibility to request the service it needs.

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[pp. 31,764 - 31,766]

[31,764]

(a) Transmission Provider's Use of Its System (Charging Yourself)

The purpose of functional unbundling is to separate the transmission component of all new transactions occurring under the Final Rule pro forma tariff, thereby assisting in the verification of a transmission provider's compliance with the comparability requirement. For example, if a transmission provider makes an off-system power sale, functional unbundling requires that the revenues received from that third-party customer be unbundled into specific transmission and production components. The transmission component of the revenues would be the product of the amount of

transmission capacity used in making the sale and the applicable rate. With respect to off-system sales, the transmission provider would book to operating revenue accounts those revenues received from the customer to whom it made the off-system sale. We will require that the transmission service component and energy component of those revenues be recorded in separate subaccounts of Account 447, Sales for Resale.

(b) Facilities and System Impact Studies

Comparability mandates that to the extent a transmission provider charges transmission customers for the costs of performing specific facilities or system impact studies related to a service request, the transmission provider also must separately record the costs associated with specific studies undertaken on behalf of its own native load customers, or, for example, for making an off-system sale. Utilities choosing this method of recovering the cost of specific studies must keep detailed expense records pertaining to each specific study. We will require utilities to record the cost of such studies that are properly includable in the determination of net income for the period in a separate subaccount of Account 566, Miscellaneous Transmission Expenses. We note, however, that not all studies performed by a transmission provider will benefit only a single customer. To the extent a transmission provider performs a system impact study that is useful in providing service to all transmission customers, the costs should be allocated to all customers.

(c) Ancillary Services

To ensure comparable transmission access a transmission provider is obligated to provide, or offer to provide, certain ancillary services to the transmission customer. Also, the transmission provider may offer to provide other ancillary services to the transmission customer, as discussed in Section IV.D. A transmission customer is obligated to purchase certain ancillary services from the transmission provider.

Generation resources provide certain ancillary services, while transmission resources provide other ancillary services. Consequently, the costs of providing certain ancillary services are recorded in the transmission provider's power production expense accounts,[504] while others are recorded in the transmission provider's transmission expense accounts.

Some commenters suggest that there may be a need for revising the Uniform System of Accounts to better track the **[31,765]** costs of providing discrete ancillary services. Other commenters believe that ancillary services are transmission-type services and suggested that the costs of generation-provided ancillary services be refunctionalized from power production expense to transmission expense.

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[504]This discussion applies to vertically integrated transmission providers. It may not apply, for example, to a transmission-only company or an independent system operator.

Currently, the Uniform System of Accounts requires that costs incurred in providing ancillary services are recorded as power production or transmission expense depending upon which resource the transmission provider uses to supply the service. At this time, we are not convinced that the amounts involved or the difficulty associated with measuring the cost of ancillary services warrants a departure from our present accounting requirements. However, in calculating separate rates for specific ancillary services utilities must maintain sufficient records and cost support for the derivation of the rates. Additionally, we will specify that the revenues a Transmission Provider receives from providing ancillary services must be recorded by type of service in Account 447, Sales for Resale, or Account 456, Other Electric Revenues, as appropriate.

(3) Liability and Indemnification

A number of commenters addressed the liability and indemnification provisions of the proposed pro forma tariffs. Duke argues that the proposed language confuses and conflates the limitation on the Transmission Provider's and Customer's rights against each other if a force majeure event occurs, and the requirement of indemnification against claims by third parties.

EEI argues that the proposed indemnification provision is inappropriate because it applies both ways, that is, the Transmission Provider and Customer indemnify each other against third party claims arising on their own systems. EEI suggests that the provision, as written, could result in the utility being required to indemnify the customer against damages incurred if, for example, an individual pried open a

transformer to steal materials and in the process was electrocuted. This concern was also voiced by Consolidated Edison, NYSEG, and Virginia Electric and Power Company. Consumer Power suggests that the best answer to this issue may be to leave the issue of allocation of risk to the contracting parties, to be resolved by negotiation when a Service Agreement is drawn up.

The Coalition for a Competitive Market, on the other hand, argues that the indemnification provision, as proposed, provides too much of a limitation of the Transmission Provider's liability, requiring gross negligence rather than simple negligence before the Transmission Provider can be held liable for damages to third parties arising from the Transmission Provider's actions.

Commission Conclusion

We agree with the commenters that these risk allocation provisions must be carefully drafted so that transmission providers and customers can accurately assess and account for their respective risks. The indemnification provision has now been broken into two parts. The first part is a force majeure provision which provides that neither the transmission provider nor the customer will be in default if a force majeure event occurs, but also provides that both the transmission provider and customer will take all reasonable steps to comply with the tariff despite the occurrence of a force majeure event. This protection against unexpected and unpredictable events is appropriately made available to both the transmission provider and transmission customer.

The second portion of the provision provides for indemnification against third party claims arising from the performance of obligations under the tariff. We have limited the indemnification portion of the provision so that it is now only the transmission customer who indemnifies the transmission provider from the claims of third parties. The customer is taking service from the transmission provider and may appropriately be asked to bear the risks of third-party suits arising from the provision of service to the customer under the tariff. We find that this new indemnification provision would be too strict if it required customers to indemnify transmission providers even in cases where the transmission provider is negligent. See Pacific Interstate Offshore Company, 62 FERC para. 61,260 at 62,733-34 (requiring amendment of indemnification provisions that required indemnification except in cases of "gross negligence"). Accordingly, the revised provision provides that the customer will not be required to **[31,766]** indemnify the transmission provider in the case of negligence or intentional wrongdoing by the transmission provider.

(4) Miscellaneous Clarifications

(a) Electronic Format

In the NOPR, we proposed that public utilities making Stage Two filings be required, in addition to the requirements specified in Part 35, to file copies of such filings on a diskette in ASCII format. We will now require that public utilities, in addition to complying with the requirements of Part 35, submit a complete electronic version of all transmission tariffs and service agreements in a word processor format, with the diskette labeled as to the format (including version) used,

initially and each time changes are filed. After the initial compliance filing, utilities proposing changes to the Final Rule pro forma tariff terms and conditions must provide a detailed list of changes and, to the extent practicable, provide an electronic version that reflects changes in redline/strikeout format.

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[pp. 31,770 - 31,785]

[31,770]

I. Federal and State Jurisdiction: Transmission/Local Distribution In the original Stranded Cost NOPR, the Commission clarified that it has exclusive jurisdiction over unbundled retail transmission in interstate commerce by public utilities: it found that the Commission has exclusive jurisdiction over the rates, terms, and conditions of unbundled retail transmission in interstate commerce by public utilities, up to the point of local distribution. In the Open Access NOPR, the Commission reaffirmed this jurisdictional determination[515] and also **[31,771]** addressed the distinction

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[515]That determination included the situation in which a former bundled retail customer may need unbundled wheeling services from its previous public utility generation supplier, as well as unbundled wheeling from one or more intervening public utilities, in order to reach a distant generation supplier. In that scenario, the Commission would have jurisdiction over all of the transmission facilities used for the unbundled wheeling provided by the intervening public utilities. The NOPR also noted that the Commission would not have jurisdiction over the rates for the sale of generation by the distant supplier because the transaction would

between transmission and local distribution. The Commission stated three reasons for expressing its views on the distinction between Commission-jurisdictional transmission in interstate commerce and state-jurisdictional local distribution, in the context of unbundled retail wheeling by public utilities.[516] First, facilities that can be used for wholesale transmission in interstate commerce by a public utility would be subject to the Commission's open access requirements. Second, states have authority to address retail stranded costs and stranded benefits through their jurisdiction over facilities used in local distribution. Third, as the structure of the industry continues to change dramatically, utilities need to know which regulator has jurisdiction over which facilities and services in order to meet state and federal filing requirements. Accordingly, the NOPR set forth our jurisdictional analysis and several technical factors, for determining what constitutes "facilities used in local distribution."

For unbundled wholesale wheeling, the NOPR proposed to apply a functional test, i.e., whether the entity to whom the power is delivered is a lawful reseller. For unbundled retail wheeling, the NOPR proposed to apply a

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be a retail sale. *FERC Statutes and Regulations* ¶32,514 at p. 33,144.

[516]The term "wheeling" is intended to cover any delivery of electric energy from a supplier to a purchaser, i.e., transmission, distribution, and/or local distribution. The Commission also has jurisdiction to order wholesale transmission services in either interstate or intrastate commerce by transmitting utilities that are not also public utilities. *See Tex-La Electric Cooperative of Texas, Inc.*, 67 FERC ¶61,019 (1994), reh'g pending.

combination functional-technical test that would take into account technical characteristics of the facilities used for the wheeling. The Commission proposed seven indicators of local distribution to be evaluated on a case-by-case basis:

(1) Local distribution facilities are normally in close proximity to retail customers.

(2) Local distribution facilities are primarily radial in character.

(3) Power flows into local distribution systems; it rarely, if ever, flows out.

(4) When power enters a local distribution system, it is not reconsigned or transported on to some other market.

(5) Power entering a local distribution system is consumed in a comparatively restricted geographical area.

(6) Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.

(7) Local distribution systems will be of reduced voltage.[517]

The NOPR concluded that the application of these tests will enable states to address stranded costs by imposing an exit fee on departing retail customers, or including an adder

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[517] *FERC Statutes and Regulations* ¶32,514 at p. 33,145.

in the retail customers' local distribution rates.[518] In the NOPR, the Commission also addressed buy-sell transactions in which an end user arranges for the purchase of generation from a third-party supplier and a public utility transmits that energy in interstate commerce and re-sells it as part of a "nominal" bundled retail sale to the end user. We explained that the retail sale is actually the functional equivalent of two unbundled sales (one transmission and the other the sale of power) and that we have exclusive jurisdiction over the voluntary sale by public utilities of unbundled transmission at retail in interstate commerce.[519]

Several commenters support the Commission's proposed jurisdictional demarcation.[520] **[31,772]** San Diego G&E states that the Commission correctly proposed to look at both functional factors (such as whether the service is retail or wholesale) and technical factors (such as voltage). PG&E states that the NOPR's functional/technical test is preferable to a bright line voltage test.

Consumers Power states that the Commission has exclusive jurisdiction over all wheeling on an interconnected interstate transmission grid. It suggests that the Commission and the states act through a joint board or hearing to resolve jurisdictional differences and develop a bright line test.

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[518]Id. at p. 33,144-45.

[519]As discussed infra, there also would be a component of local distribution in such a transaction that would be subject to state jurisdiction.

[520]*E.g.*, PG&E, Wisconsin Coalition, Com Ed.

PSE&G and PG&E express concern that if retail wheeling is implemented, there may be loopholes that would enable customers to evade state jurisdiction and thus avoid paying stranded costs. For example, PSE&G is concerned that a retail customer may request transmission service only and a state commission will be unable to attach a retail stranded cost surcharge to that customer. PG&E proposes adding another indicator to the functional/technical test -- a final tap to a retail customer -- to ensure that "high-voltage" retail customers do not evade the state's reach. Moreover, to ensure that retail customers cannot escape state jurisdiction, PG&E recommends that the Commission state, as a matter of policy, that "all retail customers taking retail transmission service from their host utility by definition take service over local distribution facilities."

CINergy agrees with the Commission that a distinction between transmission and local distribution is important, but emphasizes the practical need for clarity on a timely basis. To achieve certainty, CINergy proposes that the Commission allow public utilities to file, under section 205, classifications of their facilities as transmission or local distribution. CCEM endorses CINergy's proposal. Although NARUC disagrees that the Commission has jurisdiction over unbundled retail transmission, if the Commission reaffirms the NOPR regarding its jurisdiction, then NARUC supports CINergy's proposal.

PSE&G strongly supports the Commission's proposed case-by-case methodology for determining whether facilities should be classified as transmission or local distribution. SoCal Edison argues that since a utility may have difficulty determining which of its facilities are transmission and which

are local distribution, utilities and states should be able to ask the Commission to classify a particular facility. Portland and Orange & Rockland suggest that the Commission provide a forum to resolve disputes over the correct classification of particular facilities.

Ohio Edison states that the Commission should assume jurisdiction over unbundled retail transmission, but only where a state has required this unbundling. It also believes that the Commission should assert jurisdiction over the ancillary services necessary to provide this jurisdictional service.

NYSEG argues that the Commission lacks jurisdiction over the transmission component of bundled retail service. On the other hand, NYSEG argues that the statute, legislative history, and case law reveal that the Commission has jurisdiction over unbundled retail wheeling from source to load, since it is transmission in interstate commerce. NYSEG argues that the "local distribution" exception to the Commission's jurisdiction applies only to bundled sales of power at retail.

Several state commissions assert that states have rate authority over all facilities used to provide retail service.[521] IL Com argues that states have rate authority over all facilities used to provide retail service, regardless of whether the NOPR would classify these facilities as transmission or local distribution.

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[521] *E.g.*, NM Com, NC Com, AZ Com.

MI Com, citing Connecticut Light & Power Company v. Federal Power Commission, 324 U.S. 515 (1945) (CL&P), and Arkansas Electric Cooperative v. Arkansas Public Service Commission, 461 U.S. 375, 393-94 (1983), contends that states have plenary jurisdiction over all aspects of retail service, including retail access and unbundled retail transmission service. It asserts that the Commission's effort to expand federal jurisdiction into transmission in connection with retail sales is without statutory justification.

Legal Environmental Assistance argues that the NOPR creates confusion about, and may intrude onto, state jurisdiction. **[31,773]** NYMEX argues that when a state orders retail wheeling, the state should have jurisdiction over that transmission-only service.

Oklahoma G&E, citing CL&P and United States v. California Public Utilities Commission, 345 U.S. 295, 316 (1953), asserts that the Commission failed to explain that the term "transmission in interstate commerce" could have different meanings depending on the factual context in which the term is applied. It argues that "transmission in interstate commerce" means the movement, in bulk, of electric energy flowing in interstate commerce, as opposed to the movement of electric energy that has been subdivided for delivery to consumers.

Oklahoma G&E further argues that "[t]he distinction between interconnected operation and radial operation corresponds precisely to this distinction between activities that have potential interstate effects and those that might have interstate effects but are a matter of primarily local

concern."[522] Oklahoma G&E also disagrees that the transportation of electric energy sold at wholesale necessarily constitutes transmission in interstate commerce. It argues that the Commission has misapplied case precedent and, by focusing on the level of the associated power sale, the Commission has misunderstood what constitutes a functional distinction between transmission in interstate commerce and local distribution.

NY Com asserts that the grant of jurisdiction to the Commission over wholesale power transactions in interstate commerce under section 201 of the FPA does not reduce the states' authority over local distribution (citing CL&P and Federal Power Commission v. Florida Power & Light Company, 404 U.S. 453, 467 (1972)). NY Com argues that the NOPR's assertion of exclusive jurisdiction over all facilities used to deliver electricity for resale, even those traditionally regarded as local distribution, violates Congress' assignment of local electric distribution to the states. It takes issue with the Commission's list of factors and says that states and the Commission should agree on a definition that preserves the traditional classification of local distribution facilities. According to NY Com, such definition should focus on the functional characteristics of local electric systems -- i.e., electricity flows into a comparatively restricted geographic area and does not flow back out of that area, and the power is consumed in that area.

NY IOUs argue that the Commission has jurisdiction over unbundled, but not bundled retail wheeling. It says that

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[522]Oklahoma G&E Initial Comments at p. 16.

other factors, including the indicators listed in the NOPR, are irrelevant, and that even long-distance interstate transmission is under state jurisdiction as long as it is bundled with a retail sale. According to NY IOUs, this is the plain meaning of the FPA; resort to legislative history is unnecessary. NY IOUs bases this view on section 201(a), which says that federal regulation extends only to matters not subject to state regulation. NY IOUs says that the only matters subject to state regulation were bundled retail sales, and that since transmission was part of the bundle, Congress intended transmission to stay under state authority as long as it is part of that bundle. It also cites section 201(b), which sets forth exceptions from Commission jurisdiction, and section 201(c), which defines "transmission in interstate commerce" and thus also controls the definition of transmission in intrastate commerce. Finally, NY IOUs argues that the legislative history supports its view, as does the case law.

Central Louisiana believes that the costs of requiring a transmission provider to take unbundled transmission service for both wholesale and retail purposes would far exceed any benefits. In this regard, Central Louisiana says that states clearly have jurisdiction over bundled retail transmission charges and that the proposed approach could not be implemented without states giving up jurisdiction or the passage of new federal legislation.

MN DPS disagrees on legal and policy grounds with the Commission's assertion of jurisdiction over unbundled retail transmission services.[523] It maintains that the

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[523]See also OH Com.

Commission's arguments do not negate the language of the FPA specifying that regulation of retail sales of electric energy is reserved to the states. MN DPS argues that the Commission's arguments **[31,774]** in support of its position are not on point because the issue is state authority to set rates for retail sales, not interstate commerce. Further, it declares that jurisdiction over a service does not change simply because it is priced differently.

Several commenters argue that unbundled pricing should not expand the Commission's jurisdiction.[524] NARUC argues that the NOPR did not explain why the Commission's authority attaches only to unbundled retail transmission service, why unbundling is jurisdictionally significant, and how transmission of electricity to end users differs from unbundled interstate transmission of natural gas by local distribution companies, which is subject to state regulation. Thus, NARUC urges the Commission not to claim jurisdiction over unbundled retail transmission services.

NARUC also argues that the Commission's test for distinguishing between transmission and local distribution is not a bright line as discussed in Federal Power Commission v. Southern California Edison Company, 376 U.S. 205 (1964) (Colton). NARUC concludes that when a state determines to enable a retail customer to purchase power from a third-party provider, that state retains the authority to regulate the delivery service provided by the utility.

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[524] *E.g.*, DOD, NM Com, KY Com, ABATE.

IL Com asserts that the test should be whether the utility function over which the Commission seeks to exercise jurisdiction is one which falls within the Attleboro gap.[525] It argues that the Commission has no legal authority to prescribe conditions under which a public utility may provide transmission service within its own service territory to its own retail customers. IL Com concedes that the court cases cited by the Commission can be interpreted to support widely disparate legal and policy positions, but argues that those cases resolved questions of Commission jurisdiction in circumstances where wholesale sales of electric power were being examined and not circumstances where retail sales are being considered. It contends that the question of whether the Commission should exercise jurisdiction over all transmission in retail wheeling has never been addressed before and requires a careful examination of the underlying purposes of Congress in enacting the FPA. IL Com explains that transmission by an Illinois utility of power to a retail consumer within its own service territory is not subject to Commission jurisdiction because that transmission was never within the Attleboro gap and has always been regulated by states.

OK Com recommends that the Commission apply to the electric industry the same policy that it has adopted concerning its regulation of the gas industry and leave unbundled retail service regulation to state authorities.

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[525] *See Public Utilities Commission v. Attleboro Steam & Electric Company*, 273 U.S. 83 (1927).

WI Com argues that if a utility offers unbundled retail access, jurisdiction over transmission services should continue to be based upon the historical demarcation between wholesale and retail transactions. KY Com argues that Congress did not intend, by authorizing wholesale wheeling in the Energy Policy Act, to change the longstanding division of jurisdiction between the Commission and the states. It claims that the NOPR ignores the limitation in the FPA that the Commission has no jurisdiction over retail sales service. NV Com cites several cases noting the states' historical authority to regulate retail rates.

IA Com proposes a definition of local distribution and transmission that would preserve the jurisdictional status quo and does not put a state commission in the position of losing authority over certain elements of a retail transaction should it allow retail wheeling. IA Com's proposed definition is as follows:

Distribution -- Service provided by a utility directly connected to an ultimate consumer of electricity is a distribution service with respect to electric energy delivered to that consumer.

Transmission -- Service provided by a utility with respect to electric energy to be delivered to an ultimate consumer through another utility is a transmission service.[526] **[31,775]**

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[526]IA Com Initial Comments at p. 4.

Montana Power states that a reasonable way to give effect to the "local distribution" exemption is to define "local distribution" as a bundled retail sale, even if interstate facilities are used.

Several commenters criticized the NOPR's functional/physical indicators. PA Com disagrees with the Commission's discussion of the FPA's legislative history and asserts that the FPA does not address the issue of what constitutes local distribution. PA Com contends that the issue was resolved by the Supreme Court in CL&P in a manner contrary to the Commission's technical-functional test and that the NOPR minimized CL&P. NM Com asserts that the proposed engineering and functional elements for determining the status of local distribution facilities fail to account for the governmental or legalistic test requirement of the FPA as identified in CL&P.

KY Com concludes that a physical definition of distribution facilities, based on objective criteria, is consistent with the FPA and is necessary to provide a clean line of demarcation.

CO Com argues that Congress used a transactional test rather than a functional test and that Congress intended all retail transactions to be under state jurisdiction. According to CO Com, there is concurrent jurisdiction over unbundled transmission in interstate commerce to an end-user. Moreover, CO Com asserts that unbundled intrastate transmission to a wholesale purchaser is under state jurisdiction (citing section 201(b)(1)). Finally, CO Com argues that the state has authority over unbundled transmission in intrastate commerce to an end-user when the

transmission-providing utility, end-user, and generator are all within the same state.

Other commenters prefer a functional test. Natural Resources Defense, DOE, and Sustainable Energy Policy generally agree that a line needs to be drawn between transmission and local distribution but believe that the Commission's test is unnecessarily cumbersome or may lead to legal uncertainty, at least within the context of stranded benefits. Instead, Natural Resources Defense proposes the following functional test, which is based on end-use service:

The Federal Power Act does not affect state regulators' jurisdiction to apply distribution charges -- either volume-based or fixed -- to electricity that is used by any utility customer to provide end-use services (as distinguished from electricity that is purchased for resale to end-use customers).[527] Sustainable Energy Policy endorses Natural Resources Defense's position. DOE suggests that a functional definition of local distribution (i.e., electricity provided for end-use service) may be the best way to avoid legal uncertainty.

EPA argues that the Commission's proposed physical definition may encourage gaming to avoid stranded costs and costs associated with public policy goals such as energy efficiency, renewable energy development and R&D funding, and a physical definition assumes that power flows into, and not out of, distribution systems, which would not allow for distributed generation (e.g., fuel cells). Thus, EPA urges the

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[527]Natural Resources Defense Initial Comments at p. 3.

Commission to adopt a functional definition that "local distribution occurs whenever electricity is provided by a utility for end-use service." Alternatively, EPA suggests that the Commission add a provision to its approach that "the provision of electricity for end-use service generally involves local distribution." Sustainable Energy Policy suggests a non-bypassable charge levied on all users of the distribution system. It endorses the policy formulation set forth by Natural Resources Defense in its initial comments. Reynolds wants to ensure that there is always at least concurrent state jurisdiction over lines used to serve end-use customers, since only states can order retail wheeling.

Detroit Edison argues that state/federal jurisdictional issues should be resolved by focusing on the use of the facilities. It says that facilities that are used to distribute a utility's own power to its own local customers should be subject to state regulation, while the use of facilities for wholesale power transactions or wholesale or retail transmission in interstate commerce should be under federal regulation.

[31,776]

Mountain States Petroleum Assoc argues that the Commission should use a functional test based on state boundaries: if a line is in more than one state, there is Commission jurisdiction; if a line is entirely within one state, there is state jurisdiction.

MD Com states that it believes that the Commission's proposed indicators for determining where to draw the line are adequate, but adds that it does not concede the

Commission's assertion of jurisdiction over unbundled retail transmission.

Some commenters suggest that implementation of the NOPR's tests could have adverse consequences. NH Com objects to the NOPR's specific tests; for example, if the Commission asserts jurisdiction over facilities because they are not radial, New Hampshire's policy of encouraging looping rather than radial lines would have the ironic effect of destroying state jurisdiction. NJ BPU states that there may be situations when the NOPR factors would not produce the proper result. It requests that the final rule recognize the need for case-by-case flexibility in determining where federal jurisdiction ends, so that the Commission and the states can work cooperatively.

NRRI argues that the NOPR's test could make siting of new transmission lines more difficult because states have in the past required native load customers to pay that part of the transmission-related revenue requirement that is not covered by unbundled transmission service. NRRI contends that, if the Commission asserts jurisdiction over all unbundled transmission service and if there is a firm point-to-point service capacity right that has value and is reassignable, then state commissions might eliminate portions of the transmission systems subject to capacity rights from rate base. NRRI is also concerned that the NOPR's transmission/local distribution test could create a price squeeze between bundled and unbundled retail transmission rates.

IN Com argues that the NOPR's view of jurisdiction would discourage retail wheeling. It says that states will be reluctant to order wheeling if the result is that they lose

jurisdiction over the previously rolled-in transmission aspect of the service. It suggests that the Commission use negotiated rulemaking to address jurisdictional issues.

Several commenters suggest alternative approaches to jurisdictional line-drawing. NV Com suggests that the Commission consider federal and state jurisdiction over transmission by using "network" and "non-network" concepts:

> The "network" concept for regulation recognizes that there is an interstate network of electric facilities used to link generation with loads. The operation of that network is indifferent to whether the electrical flows are retail or wholesale flows. Conceptually, events on the network could fall under federal jurisdiction. Where facilities provide essential service for the delivery of power, but do not substantially affect the electrical flows on the network, the facilities fall outside the network and would remain within the traditional domain of the state commission. As a consequence the delineation of federal and state jurisdiction evolves from the recognition of the events and where they occur as opposed to a rigid consideration of the physical properties of the facilities involved.[528]

NV Com further explains that the determination of what is a network event would require a case-by-case examination.

OH Com asserts that Congress intends there to be a bright line between state and federal jurisdiction and that the Commission has failed to provide such a bright line. OH Com

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[528]NV Com Reply Comments at p. 3.

proposes the use of retail marketing areas to provide the bright line -- the jurisdictional line would be at the point at which power enters the retail marketing area of the entity delivering the power to the retail customer. OH Com cites section 212(g) of the FPA, as amended by the Energy Policy Act, which provides that the Commission cannot issue any order under the FPA inconsistent with state law governing retail marketing areas.

Under OH Com's proposal, the Commission would have jurisdiction over the wheeling-out and wheeling-through components of retail wheeling and the state would have jurisdiction over the wheeling-in component due to its local nature. OH Com concludes that the Commission's approach "fails to meet the legal standard **[31,777]** FERC must consider, and is inconsistent with the 'savings clause' and legitimacy of 'retail marketing areas' as discussed in the amended FPA."[529] OH Com also explains that the Commission's approach "is wreaking havoc on the state's ability to develop an interruptible buy-through arrangement to provide an increased competitive option for its retail customers."[530] OH Com further encourages the use of mutual

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[529]Sections 212(g) and 212(h) of the FPA.

[530]We note that since OH Com filed its comments, it approved an interruptible buy-through plan. *See Interruptible Electric Service Guidelines*, Case No. 95-866-EL-UNC, --PUR 4th-- (Ohio PUC Feb. 15, 1996). *See also Central Illinois Light Company*, Docket No. ER96-1075-000 (1996) (accepting amendment to open access transmission tariffs that expands service eligibility to accommodate participation in experimental retail wheeling pilot program approved by the Illinois Commerce

deference to promote Congress' intent in mandating a system of federal/state cooperation. In support, OH Com cites federal and state enforcement of telecommunications laws. NRRI also suggests that the jurisdictional line be drawn at the retail marketing area.

DC Com argues that the NOPR test is too difficult to administer and will create problems in determining the rate base at the state level. It suggests that the Commission should have jurisdiction over transmission from the source to the boundary of the "home" utility that delivers the power to the customer, with state jurisdiction over all aspects of the transmission service within that utility's franchise territory. AZ Com also expresses doubts that the NOPR's test is workable.

Several commenters propose that the Commission and state authorities address the jurisdictional issue jointly. SBA characterizes the Commission's proposed demarcation line as "laudable but misguided."[531] SBA recommends that a federal/state board be established to resolve the transmission/local distribution dilemma, similar to what

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Commission); *Illinois Power Company*, Docket No. ER96-1285-000, 75 FERC (1996); *cf. Illinois Power Company*, --PUR4th--, No. 95-0494 (Illinois Commerce Commission Mar. 13, 1996) (offering retail direct access service providing transmission and ancillary services using the rates, terms, and conditions of Illinois Power's open access tariff on file with the Commission); recently introduced legislation in Rhode Island, H.B. 8124, the Utility Restructuring Act of 1996.

[531]SBA Initial Comments at p. 36.

Congress did for allocating costs between interstate and intrastate communications. SBA explains that the problem in the communications industry was the impossibility of allocating a portion of a single copper wire to interstate or intrastate service.

AZ Com notes that even if the Commission is correct, the FPA clearly does not preempt a state from concluding that retail transmission or other direct access programs should be implemented in that state. AZ Com suggests that there may be concurrent jurisdiction and that mutually agreed-upon principles should be implemented to determine which jurisdiction should be given deference.

MD Com states that in determining the status of particular facilities, the Commission should give substantial weight to determinations made by states. ABATE states that the Commission could initially defer to states with respect to the determination of rates, terms, and conditions, while maintaining the right to review and overturn the state determination.

If the Commission maintains its position concerning jurisdiction, NARUC argues that the Commission should not implement its multi-factor test, but should enter into discussions with state commissions to develop workable alternatives. NH Com argues that pricing the retail part of a transaction, even if it involves use of the transmission system, should be subject only to state jurisdiction. NH Com wants to create a mechanism by which state and federal regulators combine their efforts in cooperative regulation; it suggests several alternatives such as state/federal agreements for shared jurisdiction.

KY Com and NRRI object to the statement in the NOPR that retail buy-through service is really transmission service (subject to the Commission's jurisdiction) plus a sale of generation at retail (subject to state jurisdiction). From a policy standpoint, KY Com argues that the Commission's approach creates a powerful disincentive for a state to embark on changes that otherwise might foster a more competitive environment. NRRI argues **[31,778]** that the Commission's approach may violate sections 212(g) and 212(h).

IL Com is concerned that industrial customers who get direct access may attempt to evade state jurisdiction, and thus avoid retail stranded cost charges, by bypassing facilities such as radial lines. It contends that retail wheeling rate surcharges would be a more effective means of recovering retail stranded costs if states were allowed to apply them to unbundled transmission and local distribution rates, not just the local distribution component of such rates.

NC Com asserts that "[a] significant cottage industry may well arise solely to convert retail customers into wholesale customers, thereby subverting the intent of Congress as expressly set forth in EPACT."[532] If the Commission does not adopt NARUC's proposal, NARUC asserts that the Commission's functional test should not permit an end user to bypass the distribution service provided by the utility. It urges the Commission to assure that there will be some facility involved in the transaction that will be defined as providing a local distribution service.

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[532]NC Com Initial Comments at p. 7.

NARUC also requests that the following sentence be added to proposed 18 CFR 35.27:

Nothing in this part limits the authority of a State commission in accordance with State law (1) to allow or disallow the inclusion of the costs of electric energy purchased at wholesale in retail rates subject to such State commission's jurisdiction, (2) to establish competitive procedures for the acquisition of such electric energy, or (3) to establish non-discriminatory fees for the delivery of such electric energy to retail consumers for purposes established in accordance with State law.([533])

Duke is concerned about the potential for regulatory gaps, which could lead to costs not being recovered from either federal or state jurisdiction. Duke is also concerned that where facilities are used for both wholesale and retail transactions, costs might not be recovered if federal and state regulators use different methods of cost allocation.

In response to the NOPR's proposal for functional unbundling,[534] CA Com agrees that it is important to draw a distinction between transmission and local distribution and that a bright line is not possible, but suggests that corporate or functional unbundling might provide a means to establish a workable bright line without relying on the more qualitative approach proposed in the NOPR. Arizona argues that rather than unbundling transmission for retail purposes, each utility

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[533]NARUC Reply Comments at p. 15-16.

[534]*FERC Statutes and Regulations* ¶32,514 at p. 33,080-83.

should establish a distribution function that would obtain transmission on behalf of retail customers, taking service under the utility's tariff. Arizona states that this would simplify the allocation of transmission costs, since all transmission costs would be under the Commission's jurisdiction. Arizona argues that the Commission should permit the utility to recover the distribution rate approved by the state. According to Arizona, this would create a bright line between state and federal jurisdiction.

TX Com argues that the proposed test would not be applicable to intrastate utilities in Texas because they do not operate in interstate commerce. Thus, it asserts that it should continue to regulate Electric Reliability Council of Texas (ERCOT) transmission and distribution service and deal with stranded cost issues that arise in connection with any retail wheeling initiatives.

Several commenters object to the Commission's proposal to assert jurisdiction over transactions that are buy-sell transactions in name only.[535] AEP argues that the Commission should avoid an unnecessary conflict over state/federal jurisdiction that may be caused by the NOPR's statement that buy-sell transactions are in fact transmission subject to Commission jurisdiction. It suggests that the Commission attempt to reach agreement with the states on this matter or ask Congress for any necessary statutory change. Citizens Utilities also argues that the Commission should not unbundle the interstate transmission aspect of buy-sell transactions. It says that, unlike the analogous **[31,779]** gas

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[535]See id. at p. 33,082.

contracts, buy-sell arrangements on the electric side are not an end run around clear federal jurisdiction. Further, it argues that it would be very difficult to define those buy-sell transactions that truly belong under federal jurisdiction.

IL Com also objects to the NOPR's characterization of buy-sell transactions. It argues that the fact that a transaction becomes unbundled does not suddenly make part of it under federal jurisdiction. Nucor argues that there is no need for the Commission to resolve this issue now; it suggests that the buy-sell arrangement is only tangentially related to open access. It argues that each buy-sell transaction will have to be addressed individually.

UT Com seeks clarification as to what the Commission means by buy-sell arrangements:

we currently authorize interruptible "buy-through" contracts, through which a retail customer, taking service subject to interruption for either economic or technical reasons, can opt to "buy-through" an interruption. The public utility purchases energy on behalf of the customer and sells it at cost to the customer. In our opinion, such transactions are not an example of a buy-sell transaction within the meaning of the proposed rule.[536]

DOD objects to the statement in the NOPR that "buy-sell" transactions are not really bundled retail service. It says that this view will discourage the development of innovative state programs, such as direct access programs. NYSEG also

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[536]UT Com Initial Comments at p. 4-5.

argues that buy-sell transactions are not under the Commission's jurisdiction. It argues that these transactions are unlike buy-sell transactions on the gas side, where the Commission asserted jurisdiction to prevent LDCs from circumventing the nondiscrimination standard it imposed on the release of capacity. NYSEG says:

> In contrast to its regulation of gas buy-sells, if the Commission regulates electric buy-sell transactions it would forego regulation of a transaction in which the Commission has a significant interest (i.e., access to the upstream seller's transmission), to regulate a transaction in which the Commission has virtually no interest (i.e., access to the distributing utility's system). Electric utilities must serve each retail customer irrespective of whether the customer takes traditional bundled service or retail buy-sell service. Unlike excess upstream gas pipeline capacity, the capacity on the local utility's electric system would not be allocated to another customer in a FERC jurisdictional transaction absent the electric buy-sell transaction. Electric buy-sell transactions are not designed so as to manipulate the assignment of upstream transmission capacity. Consequently, the impetus for FERC to reclassify gas buy-sell transactions as capacity assignments is not present in the electric context.[537]

NYSEG argues that there are only two possible grounds for the Commission's assertion of jurisdiction over electric buy-sell transactions: either (1) the sale for resale by the supplier is really a sale at retail to the end user, and the resale by the local utility is really unbundled retail wheeling;

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[537]NYSEG Initial Comments at p. 48 (footnote omitted).

or (2) the Commission has jurisdiction over transmission service that is part of bundled retail service. It claims that the second ground is invalid because the transmission aspect of bundled retail service is distribution. It also claims that the first ground is invalid because it assumes that the sale by the supplier to the local utility is not a sale for resale even though the contract says that it is. NYSEG states:

> The logical outcome would be that FERC would not have jurisdiction over the sale by the supplier to the utility, including transmission by that supplier because it would be a bundled retail sale. This is because, if the commission holds the resale to be a retail wheel, then it would have to find that the sale by the supplier is a retail sale to the end user. The Commission cannot at once regulate the sale for resale and the "retail transmission service." The Commission would regulate the transmission rates of the local franchise utility, although it would not regulate the access to such transmission service -- a matter FERC leaves to state regulators. In the process, FERC **[31,780]** would abandon the ability to regulate access to the supplier's bundled "retail power sale and transmission service," a transaction that FERC arguably has an interest in regulating.[538]

Finally, NYSEG argues that if the Commission insists on asserting jurisdiction, it should at least grandfather existing contracts.

UT Industrials state that where there is a state barrier to a buy-sell transaction, the Commission should allow the

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[538]NYSEG Initial Comments at p. 50.

utility to file a tariff with the Commission that would permit the utility to complete a voluntary buy-sell transaction as the NOPR proposes. However, it contends that when a state regulatory authority is authorized to, and has approved buy-sell transactions, it is not necessary for the Commission to become involved. It urges the Commission to allow such transactions to take place free of Commission regulation.
Commission Conclusion

In the discussion below, the Commission addresses the following jurisdictional issues raised in the prior NOPRs:

a. Does the Commission have jurisdiction over unbundled transmission in interstate commerce by a public utility when such transmission is used to transport electric energy that is sold to an end user?

b. If so, what facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to an end user?

c. What facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to a purchaser who will then re-sell the energy to an end user?

d. What procedures are appropriate for making jurisdictional determinations?

In addition, the Commission addresses concerns raised by state regulators which indicate that competition and open

access are perceived as threatening the traditional regulatory functions of state commissions. The Federal Power Act differentiates between state and federal regulation of electric power. As we discuss below, the Commission believes that any change in state or federal jurisdiction over physical transmission assets and related costs will not affect the traditional tasks of state and federal regulators.

The wide range of jurisdictional interpretations and proposals in the comments reflects the fact that the legislative history of the FPA and case law interpreting federal/state jurisdiction under that Act and the Natural Gas Act grew out of a market structure in which electricity and transmission generally were bought and sold on a bundled basis. As a result, most transactions included either a retail or wholesale sale of electric energy and jurisdictional lines were drawn on the basis of this sale. Thus, the cases simply do not resolve dispositively these jurisdictional issues when they arise in the context of the market structures and unbundled transactions being contemplated in today's electric industry. However, after reviewing the extensive analysis of the FPA, legislative history, and case law contained in both our initial Stranded Cost NOPR and in our Open Access NOPR, and the comments received on that analysis, we continue to believe that we were correct in asserting jurisdiction over the transmission component of an unbundled interstate retail wheeling transaction. We therefore reaffirm our conclusion. We also reaffirm and clarify our determinations regarding the tests to be used to determine what constitute Commission-jurisdictional transmission facilities and what constitute state-jurisdictional local distribution facilities in situations involving

unbundled wholesale wheeling and unbundled retail wheeling.[539]

At the same time, the Commission strongly supports the efforts of states to pursue pro-competitive policies. We recognize that jurisdictional issues raise overlapping Federal and state policy concerns that call for heightened cooperation among federal and state regulators. As discussed below, where states unbundle **[31,781]** retail sales, we will give deference to their determinations as to which facilities are transmission and which are local distribution, provided that the states, in making such determinations, apply the seven criteria discussed in the NOPR and reaffirmed below. In addition, we clarify our view that there is an element of local distribution service in any unbundled retail transaction, and further clarify other aspects of our jurisdictional ruling to preserve state jurisdiction over matters that are of local concern and will remain subject to state jurisdiction if retail unbundling occurs.

We first address our legal determination that if unbundled retail transmission in interstate commerce occurs voluntarily by a public utility or as a result of a state retail access program, this Commission has exclusive jurisdiction over the rates, terms, and conditions of such transmission. No commenter has raised cases or legislative history not previously considered in our prior NOPRs, and we will not

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[539]Not only do we conclude that our determinations are legally supportable under the case law, but we believe it is imperative to provide guidance to public utilities and state regulators as to our position on where the jurisdictional boundaries lie.

repeat here our full legal analysis of this issue.[540] However, we find compelling the fact that section 201 of the FPA, on its face, gives the Commission jurisdiction over transmission in interstate commerce (by public utilities) without qualification.[541] Unlike our jurisdiction over sales of electric energy, which section 201 of the FPA specifically limits to sales at wholesale, the statute does not limit our transmission jurisdiction over public utilities to wholesale transmission.

In response to those commenters (including NARUC) who argue that the Commission did not explain why its authority attaches only to unbundled, but not bundled, retail transmission in interstate commerce by public utilities, we believe that when transmission is sold at retail as part and parcel of the delivered product called electric energy, the transaction is a sale of electric energy at retail. Under the FPA, the Commission's jurisdiction over sales of electric energy extends only to wholesale sales. However, when a retail transaction is broken into two products that are sold

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[540]The Commission's complete legal analysis on this issue, and on the related issue of what facilities are Commission-jurisdictional transmission facilities, and what are state jurisdictional local distribution facilities, are contained in Appendix G to this Rule.

[541]Section 201(b)(1) specifically exempts from Commission jurisdiction facilities used for transmission in intrastate commerce and transmission of electric energy consumed wholly by the transmitter. As a result, we have no jurisdiction over retail wheeling that occurs in Alaska, Hawaii and the Electric Reliability Council (ERCOT) portion of Texas since transactions in those areas are intrastate.

separately (perhaps by two different suppliers: an electric energy supplier and a transmission supplier), we believe the jurisdictional lines change. In this situation, the state clearly retains jurisdiction over the sale of the power. However, the unbundled transmission service involves only the provision of "transmission in interstate commerce" which, under the FPA, is exclusively within the jurisdiction of the Commission. Therefore, when a bundled retail sale is unbundled and becomes separate transmission and power sales transactions, the resulting transmission transaction falls within the Federal sphere of regulation.

In asserting jurisdiction over unbundled retail transmission in interstate commerce by public utilities, the Commission in no way is asserting jurisdiction to order retail transmission directly to an ultimate consumer. Section 212(h) of the FPA clearly prohibits us from doing so. In addition, as stated in both the initial Stranded Cost NOPR and the Open Access NOPR, we do not address whether states have authority to order retail wheeling in interstate commerce. The Commission's assertion of jurisdiction is that if retail transmission in interstate commerce by a public utility occurs voluntarily or as a result of a state retail wheeling program, the Commission has exclusive jurisdiction over the rates, terms, and conditions of such transmission and public utilities offering such transmission must comply with the FPA by filing proposed rate schedules under section 205.

The Commission clarifies that nothing in this jurisdictional determination changes historical state franchise areas or interferes with state laws governing retail marketing areas of electric utilities. Section 212(g) of the FPA prohibits Commission orders that would be inconsistent with such laws.

However, we reject arguments made by some of the commenters **[31,782]** that section 212(g) could somehow be construed to give states authority over the rates, terms, and conditions of unbundled interstate transmission within retail marketing areas.[542] While our jurisdiction cannot affect whether and to whom a retail electric service territory (marketing area) is to be granted by the state, and whether such grant is exclusive or non-exclusive, neither can state jurisdiction affect this Commission's exclusivejurisdiction over transmission in interstate commerce by public utilities.

In response to several of the commenters, we further clarify that the Commission's jurisdiction over the rates, terms, and conditions of unbundled retail transmission is no broader than our authority over transmission used for wholesale transactions, and will not affect matters otherwise

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[542]The legislative history of FPA section 212(g) and its predecessor, former section 211(c)(3), indicates that the provision was focused on not interfering with state laws governing retail service territories and not permitting Commission wheeling orders "for purposes of sale by a utility to an ultimate consumer who is within the service territory of another utility (other than the applicant) where such territory is established by or under State law, rule, or decision." See H.R. Conf. Rep. No. 1750, 95th Cong., 2d Sess. 92 (1978), reprinted in 1978 U.S. Code Cong. & Ad. News 7797, 7826. Nothing on the face of section 212(g) or the legislative history of either the Energy Policy Act or PURPA indicates that the provision in any way affects the Commission's authority over rates, terms, and conditions of transmission in interstate commerce by public utilities.

left to the states by Congress.[543] The Federal Power Act recognizes that retail marketing areas are governed by state law. Moreover, we believe that states have authority over the service of delivering electric energy to end users. In exercising this authority, state regulatory commissions and state legislatures have traditionally developed social and environmental programs suited to the circumstances of their states. State regulation of most power production and virtually all distribution and consumption of electric energy is clearly distinguishable from this Commission's responsibility to ensure open and non-discriminatory interstate transmission service. Nothing adopted by the Commission today, including its interpretation of its authority over retail transmission or how the separate distribution and transmission functions and assets are discerned when retail service is unbundled, is inconsistent with traditional state regulatory authority in this area.

The Commission reiterates its strong interest in preventing any balkanization of the interstate power market. Although the Commission believes its Final Rule will accommodate retail competition, if it is offered voluntarily by a utility or ordered by a state, our policies relate only to the bulk power market and not traditional state regulation of the retail market.[544]

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[543]Among other things, Congress left to the States authority to regulate generation and transmission siting. See FPA sections 201(b) and 211(d)(1); Section 731 of the Energy Policy Act.

[544]This Final Rule will not affect or encroach upon state authority in such traditional areas as the authority over local service issues, including reliability of local service; administration of

NARUC has requested that the Commission specifically clarify in §35.27 of its proposed rules[545] that nothing in our final rule limits the authority of a state commission "to allow or disallow the inclusion of the costs of electric energy purchased at wholesale in retail rates subject to such State commission jurisdiction." We will adopt NARUC's proposal with modification, but add it as a separate subsection. The Final Rule adopts a new §35.27(b) as follows:

Nothing in this part (i) shall be construed as preempting or affecting any jurisdiction a state commission or other state authority mayhave under applicable state and federal law, or (ii) limits the authority of a state commission in accordance with state and federal law to establish (a) competitive procedures for the **[31,783]** acquisition of electric energy, including demand-side management, purchased at wholesale, or (b) non-discriminatory fees for the distribution of such electric energy to retail consumers for purposes established in accordance with state law.

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integrated resource planning and utility buy-side and demand-side decisions, including DSM; authority over utility generation and resource portfolios; and authority to impose non-bypassable distribution or retail stranded cost charges.

[545]Section 35.27 of the proposed rules provided that any public utility seeking authorization to engage in sales for resale at market-based rates shall not be required to demonstrate any lack of market power in generation with respect to sales from capacity first placed in service on or after 30 days from the date of publication of the Final Rule in the Federal Register. *FERC Statutes and Regulations* ¶32,514 at p. 33,154.

With respect to the Commission's adoption of the Open Access NOPR's functional/technical tests for determining what facilities are Commission-jurisdictional facilities used for transmission in interstate commerce and what facilities are state-jurisdictional local distribution facilities, the case law supports a bright line for unbundled wholesale transmission, i.e., transmission of electric energy that is being sold for resale. This is consistent with the bright line drawn by Congress to fill the Attleboro gap for regulating wholesale sales of electric energy. The case law also supports a bright line with respect to retail transmission by intervening utilities, i.e., transmission by those utilities between the new retail generation supplier and the public utility that previously provided bundled retail service to the end user. However, despite many commenters' arguments to the contrary, we cannot divine such a bright line for unbundled retail transmission by the public utility that previously provided bundled retail service to the end user. In fact, the limited case law, including CL&P and Colton, supports a case-by-case determination.[546] Accordingly, we believe our technical test, with its seven indicators, will permit reasoned factual determinations in individual cases.

Although we are unable to draw the bright line for local distribution facilities that many commenters would like, we believe it is important to make two clarifications regarding local distribution in the context of retail wheeling. First, even

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[546]As noted, the Commission's detailed legal analysis is contained in Appendix G. We are particularly persuaded by the Supreme Court's statement that whether facilities are used in local distribution is a question of fact to be decided by the Commission as an original matter. See CL&P, 515 U.S. at p. 534-35.

when our technical test for local distribution facilities identifies no local distribution facilities for a specific transaction, we believe that states have authority over the service of delivering electric energy to end users. Second, through their jurisdiction over retail delivery services, states have authority not only to assess stranded costs but also to assess charges for stranded benefits, such as low-income assistance and demand-side management. Because their authority is over services, not just the facilities, states can assign stranded costs and benefits based on usage (kWh), demand (kW), or any combination or method they find appropriate. They do not have to assign them to specific facilities.[547]

Thus, while we believe in most cases there will be identifiable local distribution facilities subject to state jurisdiction, we also believe that even where there are no identifiable local distribution facilities, states nevertheless have jurisdiction in all circumstances over the service of delivering energy to end users. Under this interpretation of state/federal jurisdiction, customers have no incentive to structure a purchase so as to avoid using identifiable local distribution facilities in order to bypass state jurisdiction and thus avoid being assessed charges for stranded costs and benefits.

Based on concerns raised by state commissions as well as some utilities, we have further determined that it is

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[547]As noted above, states retain authority over state integrated resource planning, utility resource portfolios, and utility buy-side and demand-side decisions.

appropriate to provide deference to state commission recommendations regarding certain transmission/local distribution matters that arise when retail wheeling occurs. We also believe it is important to develop mechanisms to avoid regulatory conflict and to help provide certainty to utilities as to which regulator has jurisdiction over which facilities. These are discussed below.

Determining where to draw the jurisdictional line for facilities used in unbundled retail wheeling transactions will involve case-specific determinations that evaluate the seven local distribution indicators that we are adopting. We believe that the Commission should take advantage of state regulatory authorities' knowledge and expertise concerning the facilities of the utilities that they regulate. Therefore, in instances of unbundled retail wheeling that occurs as a result of a **[31,784]** state retail access program, we will defer to recommendations by state regulatory authorities concerning where to draw the jurisdictional line under the Commission's technical test for local distribution facilities, and how to allocate costs for such facilities to be included in rates, provided that such recommendations are consistent with the essential elements of the Final Rule.[548] Moreover, we recognize that in some cases the Commission's seven technical factors may not be fully dispositive and that states may find other technical factors that may be relevant. We will consider jurisdictional recommendations by states that take into account other

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[548]In order to give such deference, we expect state regulators to specifically evaluate the seven indicators and any other relevant facts and to make recommendations consistent with the essential elements of the Rule.

technical factors that the state believes are appropriate in light of historical uses of particular facilities.

Some commenters have asked the Commission to provide a forum to prevent or resolve disputes over the correct classification of facilities as transmission or local distribution. As a means of facilitating jurisdictional line-drawing, we will entertain proposals by public utilities, filed under section 205 of the FPA, containing classifications and/or cost allocations for transmission and local distribution facilities. However, as a prerequisite to filing transmission/local distribution facility classifications and/or cost allocations with the Commission, utilities must consult with their state regulatory authorities. If the utility's classifications and/or cost allocations are supported by the state regulatory authorities and are consistent with the principles established in the Final Rule, the Commission will defer to such classifications and/or cost allocations.[549] We encourage public utilities and their state regulatory authorities to attempt to agree to utility-specific classifications and allocations that the utility may file at the Commission.

A number of commenters have asked the Commission to defer to state commission recommendations or decisions regarding rates, terms and conditions of unbundled retail transmission in interstate commerce by public utilities. Some have suggested that we set broad guidelines for such rates, terms, and conditions, and then allow states to actually

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[549]This should also alleviate some concerns about the potential for costs not being accounted for if the Commission and a state commission use different methods of allocating costs.

implement the guidelines. While the Commission cannot simply turn over its jurisdiction for the states to implement, we understand the concerns raised by many state regulators and believe that deference to state commissions with regard to rates, terms, and conditions may be appropriate in some circumstances, as discussed below.

As we determined in the NOPR, when unbundled retail wheeling in interstate commerce occurs, the transaction has two components for jurisdictional purposes -- a transmission component and a local distribution component. The Commission has jurisdiction over facilities used for the transmission component of the transaction, and the state has jurisdiction over facilities used for the local distribution component.[550] Thus, the rates, terms and conditions of unbundled retail transmission by a public utility must be filed at the Commission. When this occurs, we will generally expect unbundled retail wheeling customers to take service under the same FERC tariff that applies to wholesale customers. However, if the unbundled retail wheeling occurs as part of a state retail access program, it may be appropriate to have a separate retail transmission tariff[551] to accommodate the design and special needs of such programs. In such situations, the Commission will defer to state requests for

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[550]As discussed above, even if there were instances where no local distribution facilities are used, we believe states have authority over the service of delivering electric energy to end users.

[551]*I.e.*, the tariff would be different from the tariff that applies to wholesale customers. Such tariff would still be filed with the Commission under FPA section 205.

variations from the FERC wholesale tariff to meet these local concerns, so long as the separate retail tariff is consistent with the Commission's open access policies and comparability principles reflected in the tariff prescribed by this Final Rule. In addition, rates must be consistent with our Transmission Pricing **[31,785]** Policy Statement, and the guidance herein concerning ancillary services.[552]

A final jurisdictional issue raised in the Open Access NOPR concerns buy-sell transactions. We remain concerned, just as we were with buy-sell arrangements in the gas industry, that buy-sell arrangements can be used by parties to obfuscate the true transactions taking place and thereby allow parties to circumvent Commission regulation of transmission in interstate commerce. Thus, we reaffirm our conclusion that we have jurisdiction over the interstate transmission component of transactions in which an end user arranges for the purchase of generation from a third-party. However, we recognize that there is a wide range of programs and transactions that might or might not fall within this category. We will address these on a case-by-case basis.

In summary, the Commission reaffirms and clarifies its prior jurisdictional conclusions and tests for determining the demarcation between federal and state jurisdiction over transmission in interstate commerce and local distribution. We have attempted to address these issues in a way that provides

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[552]In applying the principles of the Final Rule to retail transmission tariffs, the Commission clearly cannot order retail wheeling directly to an ultimate consumer. See FPA section 212(h).

for flexibility and recognition of legitimate state concerns. With regard to retail services, we recognize the states' concerns that the unbundling of retail transactions would result in changes from what historically has been regulated by the states (principally, the rates of transmission assets previously included in retail rate base). However, the decision to provide unbundled retail wheeling is not the Commission's to make because we have no authority to order transmission directly to an ultimate consumer. In addition, even if a retail access program occurs, we do not believe the unbundling of retail transactions will radically change fundamental state authorities, including authority to regulate the vast majority of generation asset costs, the siting and maintenance of generation facilities and transmission lines, and decisions regarding retail service territories. Further, the Commission intends to be respectful of state objectives so long as they do not balkanize interstate transmission of power or conflict with our interstate open access policies. As the electric industry and state regulatory authorities continue to develop new competitive market structures and consider retail wheeling programs, we believe that the tests and mechanisms we have provided in this Rule will accommodate both Federal and state interests and will help provide jurisdictional certainty to market participants.

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[31,898]

1. Public Utilities

As with the Open Access Final Rule, there are not a substantial number of public utilities that qualify under the SBA's definition of small electric utility that are subject to the Stranded Cost Final Rule. The Stranded Cost Rule applies only to public utilities that seek stranded cost recovery in connection with a limited set of wholesale requirements contracts (those executed on or before July 11, 1994 that do not contain an exit fee or other explicit stranded cost provision). To the extent that public utilities seek stranded cost recovery, they will do so in a rate filing, where stranded cost recovery is likely to be one of many items considered. Accordingly, the Stranded Cost Final Rule will not pose a significant economic impact on a substantial number of public utility small entities.

2. Non-Public Utilities

With regard to non-public utilities, the stranded cost issue would only arise in a proceeding under sections 211 and 212 of the FPA when, in directing transmission, the Commission addresses the stranded cost issue in determining a just and reasonable rate. As with public utilities, stranded costs will be just one more item to be considered in establishing just and reasonable rates for transmission. As a result, the Stranded Cost Final Rule will not impose a significant economic impact on a substantial number of non-public utility small entities.

C. *Conclusion*

Accordingly, the Commission certifies that these final rules will not have a significant economic impact on a substantial number of small entities.

VII. Information Collection Statement

The Office of Management and Budget's (OMB) regulations[1082] require that OMB approve certain information and recordkeeping requirements (collections of information) imposed by an agency. Upon approval of a collection of information, OMB shall assign an OMB control number and an expiration date. Respondents subject to the filing requirements of this Rule shall not be penalized for failing to respond to this collection of information unless the collection of information displays a valid OMB control number.

There are now approximately 328 public utilities, including marketers and wholesale generation entities. The Commission estimates that 166 of these utilities own, control or operate facilities used for the transmission of electric energy in interstate commerce and would be subject to the filing requirements of this Rule.

Title: FERC-516, Electric Rate Schedule Filings

Action: Final Rule

OMB Control No: 1902-0096

[1082] 5 CFR 1320.11.

Respondents: Public Utilities that own, control or operate facilities used for the transmission of electric energy in interstate commerce.

Frequency of Responses: On occasion.

Necessity of information: The Final Rule requires public utilities that own, control or operate facilities used for the transmission of electric energy in interstate commerce to have on file with the Commission non-discriminatory open access transmission tariffs that contain minimum terms and conditions of service and permits public utilities to make filings to seek recovery of legitimate, prudent and verifiable stranded costs associated with providing open access and FPA section 211 transmission services. The Commission has a mandate under sections 205 and 206 of the FPA to ensure, with respect to any transmission in interstate commerce or any sale of electric energy for resale in interstate commerce by a public utility, that no entity is subject to undue discrimination. The Commission will use the data collected in this collection of information to carry out its responsibilities under Part II of the FPA. The Commission's Office of Electric Power Regulation will use the data to review electric rate and tariff filings.

The Commission is submitting notification of this Final Rule to OMB. Interested persons may obtain information on the reporting requirements by contacting the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. **[31,899]** 20426 [Attention: Michael Miller, Information Services Division, (202) 208-1415], and to the Office of Management and Budget [Attention: Desk

Officer for the Federal Energy Regulatory Commission, (202) 395-3087].

VIII. Effective Date

This Rule will take effect on [insert date 60 days after date of publication in the Federal Register]. The Commission has determined, with the concurrence of the Administrator of the Office of Information and Regulatory Affairs of the Office of Management and Budget, that this Rule is a "major rule" within the meaning of section 351 of the Small Business Regulatory Enforcement Act of 1996.[1083] The Rule will be submitted to both Houses of Congress and the Comptroller General prior to its publication in the Federal Register.

List of Subjects

18 CFR Part 35

Electric power rates, Electric utilities, Reporting and recordkeeping requirements.

18 CFR Part 385

Administrative practice and procedure, Electric power, Penalties, Pipelines, Reporting and recordkeeping requirements.

By the Commission. Commissioner Hoecker concurred in part and dissented in part with a separate statement

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[1083] 5 U.S.C. 804(2).

attached. Commissioner Massey dissented in part with a separate statement attached. Lois D. Cashell, Secretary.

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[pp. 31,919 - 31,926]

[31,919]

Appendix C--Allegations of Public Utilities Exercising Transmission Dominance

I. Examples From Proceedings Before Administrative Law Judges

These are examples of allegations that various public utilities have refused to provide comparable service, either through refusals to wheel, dilatory tactics that so protracted negotiations as to effectively deny wheeling, refusals to provide service priority equal to native load, or refusals to provide service flexibility equivalent to the utility's own use.

A. *American Electric Power Service Corp. (AEP)*

In 1993, AEP filed, on behalf of its public utility associate companies, an open access tariff that offered only firm point-to-point service with very limited flexibility. It did not offer network service, flexible point-to-point service, or non-firm service. Thus, it did not provide customers with the same flexibility that AEP itself has. Nor did it provide a service priority equivalent to that enjoyed by native load. The Commission set AEP's tariff for hearing and, on rehearing, held that in order not to be unduly discriminatory, the tariff had to offer comparable service. American Electric **[31,920]**

Power Service Corp., 64 FERC para. 61,279 (1993), reh'g, 67 FERC para. 61,168 (1994).

At hearing, Raj Rao of Indiana Michigan Power Agency (IMPA) (Ex. IMPA-1, Feb 23, 1994) and Kenneth Hegemann of American Municipal Power-Ohio, Inc. (AMP-Ohio) (Ex. AMPO-1, Feb 23, 1994), both senior management officials, testified concerning AEP's alleged discriminatory practices.[1] AMP-Ohio is an association of municipalities in Ohio, some of whose members depend on AEP for transmission and partial requirements service. IMPA is an association of municipalities in Indiana, and many of IMPA's loads are captive to the AEP transmission system. The witnesses alleged as follows:

1. In anticipation of high peak demands, AEP would contract for large blocks of available short-term power, withhold sale of short-term power, refuse to transmit third party short-term power, and require purchases from AEP at the emergency rate (100 mill/kwh) when an emergency might not exist. Ex. AMPO-1 at 6.

2. In December 1989, AMP-Ohio negotiated a 20 MW purchase of short-term power from Louisville Gas & Electric Company (LG&E). AEP refused to wheel because LG&E had earlier that day told AEP it had no power to sell to AEP. AEP

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[1]After the Rehearing Order expanding the scope of the proceeding, AMP-Ohio and IMPA withdrew this testimony as no longer necessary. This withdrawal does not change the fact that the testimony was sworn to under oath.

then bought the power from LG&E and offered to resell it to AMP-Ohio. Ex. AMPO-1 at 6-7.

3. In January 1990, AMP-Ohio solicited bids for February power purchases from a number of utilities including AEP. AEP was not the winning bid. AMP-Ohio made arrangements to purchase the power from four winning bidders and sought transmission through AEP. When AMP-Ohio gave AEP the schedule for delivery, AEP refused to transmit the power, matched the average price of the winning bids, and made the sale itself. Ex. AMPO-1 at 7.

4. In August 1993, an AMP-Ohio member (Columbus, Ohio) was purchasing 10 MW of hourly non-displacement power from AEP and, after AEP raised its price to 60 mills/kwh, sought another source for the next hour. Consumers Power Company and Detroit Edison Company both offered non-displacement power at 40 mills. AEP refused to transmit, saying it had a 600 MW unit out and could not resell power from another source.[2] Columbus cancelled the transaction and had to buy 10 MW of power from AEP at 100 mills/kwh. Ex. AMPO-1 at 7-8.

5. In July 1993, two AMP-Ohio members (Columbus and St. Mary's) had been buying hourly non-displacement

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[2]AEP generally limited its offer of short-term transmission to buy/sell transactions; that is, AEP would buy the power from the seller and resell it to the purchaser. Supplemental testimony of AEP Witness Baker (Ex. A-73) at 27-29. Often, the terms of the buy/sell transaction required transmission dependent utilities (TDUs) to maintain reserves and meet contractual commitments for at least a year. *Id.*

power from AEP when the price rose to 35 mills. Dayton Power & Light Company (DP&L) offered to sell at 23 mills and AEP agreed to transmit for one hour. But for the next hour, AEP said it had problems with its system, refused to transmit the power, kept the power from DP&L for itself and offered to sell power to AMP-Ohio for Columbus and St. Mary's at 100 mills. Columbus increased its local generation, but St. Mary's purchased 8 MW at 100 mills. For the next hour, AMP-Ohio arranged with DP&L for another 8 MW, hoping AEP would transmit under the 24 hour buy-sell agreement. AEP did transmit this power. Seven hours later in the day, St. Mary's Greenup Hydro project power was available and the 8 MW from DP&L was no longer needed. If St. Mary's had been receiving the hourly power that AEP had refused to transmit, St. Mary's could have switched to Greenup power. But because AMP-Ohio had changed to daily service, St. Mary's had to pay a demand charge for the entire day, even though it used the power only 7 hours and would have paid less under the hourly rate. Ex. AMPO-1 at 8-9.

6. In January 1994, AMP-Ohio sought to transfer power from one member with generation to other members, which required transmission over AEP and Toledo Edison lines. Toledo Edison said yes, AEP said no. AMP-Ohio's northern members purchased emergency power from Toledo Edison. AMP-Ohio then reminded AEP that it had agreed not to deny transmission **[31,921]** and AEP agreed to transmit. Ex. AMPO-1 at 9.

7. IMPA arranged to buy 80 MW of short-term power from LG&E and have it wheeled, using buy-sell arrangements, through Public Service Company of Indiana (PSI) and AEP to serve IMPA's load at Richmond (an IMPA

member). The delivered price was $.292 per kW-day plus a 1 mill adder. At the same time AEP arranged to buy 300 MW from PSI at $.30 per kW day plus out-of-pocket energy costs. Hence, PSI was shipping a total of 380 MW to AEP with 80 MW of that amount to be delivered to IMPA's load at Richmond. Then, on a day when IMPA should have received the 80 MW, AEP told IMPA that PSI had sold everything to AEP and that IMPA would have to buy from AEP at $.63 per kW day plus the cost of energy from AEP. IMPA purchased from AEP under protest. AEP used its control over transmission to intercept the 80 MW at a lower price and resell it as short-term power to IMPA. AEP claimed that PSI had terminated its sales to AEP on that day. But the 80 MW was independent of PSI's other sales to AEP and would not have been interrupted if AEP had not interrupted it. IMPA-1 at 7.

8. IMPA has combustion turbines owned by and located at one member, which IMPA would like to connect to the Joint Transmission System owned by IMPA, CINergy and Wabash Valley Power Association. To do so, IMPA needed a metering agreement with AEP, to which AEP would not agree. IMPA-1 at 6.

9. In January 1994, IMPA had power to sell from its turbines when AEP and others needed power. IMPA offered power to AEP but AEP it said could not purchase the power without an existing contract. Moreover, since there was no short-term tariff, IMPA could not sell the power to another utility. IMPA-1 at 6.

10. Another example of the utility engaging in dilatory tactics that raised the customer's transaction costs and

effectively denied transmission is the "sham transaction" provision proposed by AEP. As filed, AEP's tariffs permitted it to deny service merely because a portion of the transmitted power might be used to serve a former retail customer of AEP. See, e.g., Ex. BR&WVP-1 (J. Bertram Solomon testimony, February 23, 1994). (As part of a settlement AEP filed the pro forma tariff and withdrew this provision.)

11. Finally, AEP's originally filed tariff contained a "prodigal customer" provision. Under this provision, transmission customers who sought to convert back to requirements service had to give AEP five years' notice, in which case AEP and the customer would enter into negotiations to determine whether AEP will provide service at all and if so under what rate, terms, and conditions. Ex. S-39 at 1 (Staff testimony). AEP did not require notice from all new customers, only from prodigal customers. Id. at 2. That a potential customer was previously served by AEP is not a reason to treat the customer differently. (AEP withdrew this provision when it filed the pro forma tariff.)

B. *Entergy Services, Inc. (Entergy)*

Entergy filed a partial settlement largely adopting the NOPR pro forma tariffs except for two provisions (headroom and ancillary services). Because the settlement predated the filing date for customer testimony before the ALJ, the customers did not address the need for Entergy to file a tariff. However, customers did make allegations of discriminatory practices, as follows.

1. Customers alleged that Entergy flat-out refused to wheel. Louisiana Energy and Power Authority (LEPA)

witness Sylvan J. Richard testified that LEPA's predecessor systems could not obtain interconnections from Entergy. Ex. SJR-1 at 50.

2. Customers also alleged that Entergy refused to provide service priority equal to native load and refused to provide service flexibility equivalent to the utility's own use. For example, LEPA witness Richard testified that even after state commissions ordered interconnections and other coordination services, LEPA's predecessors were still not able to obtain coordination services because Entergy was not willing to coordinate and because the transmission service it did offer was inflexible, unidirectional point-to-point service, which prevented economic coordination with others. Id. at 50-51.

3. South Mississippi Electric Power Association (SMEPA) witness J. Bertram Solomon testified that Entergy's original "open access" tariff was restricted to **[31,922]** point-to- point service, proposed separate charges for each operating company, and required the cancellation of existing agreements in order to take service under the proposed tariff. Ex. SMEPA-10 at 28. Entergy eventually filed a network tariff, but proposed different local facilities charges for the various Entergy public utility operating subsidiaries. Id. at 29. Since these local facilities charges were higher than the transmission component of the subsidiaries' bundled rates, Entergy obtained a competitive advantage. Id.

4. The Arkansas Cities and Cooperatives (ACC) is a group of cities and cooperatives that own or operate electric generation or distribution systems in Arkansas. ACC Witness Steven Merchant testified that Entergy has segregated the

wholesale market between two of its subsidiaries, Arkansas Power & Light Copmpany (APL) and Entergy Power, Inc. (EPI). Ex. SMM-1 at 16. In marketing power and energy in Arkansas, EPI is subject to an Arkansas Commission order that bars EPI from competing with APL for wholesale loads without first obtaining a waiver. Id. Recently, EPI requested this waiver for all wholesale transactions in Arkansas except for wholesale customers currently served by an Entergy subsidiary; in other words, EPI requested the Arkansas Commission to expand competition for all wholesale customers except where EPI might compete with APL. Id. ACC witness Merchant concluded that, since EPI does not compete with APL, Entergy insulates APL's wholesale business from competition and denies those wholesale customers access to EPI as a source of power, thereby limiting alternative generation sources available to ACC. Id. at 17-19. (Entergy's witness Kenney stated that Entergy has recently filed a joint motion with ACC to the Arkansas Commission seeking to extend the waiver and permit EPI to sell to APL's wholesale customers. Ex. JFK-11 at 14- 15.)

C. *Pacific Gas & Electric Company (PG&E)*

Northern California Power Agency (NCPA) attached several documents to its 1988 complaint in Docket No. EL89-4. These documents were provided to support NCPA's claim that PG&E's unreasonable practices under the PG&E/NCPA Interconnection Agreement (IA) effectively denied NCPA access to transmission properly requested under the IA. Although the parties eventually settled and the Commission terminated the docket with a letter order dated May 18, 1988, these documents provide allegations of PG&E using dilatory

tactics that so protracted negotiations as to effectively equal a refusal to wheel.[3]

1. PG&E stated that since transmission was not currently available, it was entitled to wait 72 months before providing transmission; that is, transmission access could not be granted before the passing of the 72-month notice period. NCPA 1988 Complaint, Ex. 3. However, the IA provided that transmission be provided when it becomes actually available. PG&E also requested substantial additional information, which NCPA considered beyond that reasonably necessary for a study, but still provided. PG&E then determined that transmission was not available, reasoning that transmission was unavailable unless all the transmission requested could be provided 8760 hours per year without restrictions or limitations, extending through the expiration of the agreement in 2013. NCPA 1988 Complaint at 9.

2. On November 27, 1987, NCPA made a new transmission request to PG&E, seeking 50 MW of bi-directional transmission at Midway. NCPA 1988 Complaint, Ex. 5. On January 28, 1988, PG&E filed an interconnection agreement with Turlock Irrigation District (TID) that provided TID with 50 MW of bi-directional transmission at

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[3]All of these incidents are related to and examples of PG&E's conduct described in the NOPR (*FERC Statutes and Regulations* ¶32,514 at p. 33,073 n.151), that is, the history of PG&E's attempt to avoid its commitments made to the California owners of the California Oregon Transmission Project (COTP). However, these incidents are not exactly the same as the incidents described in the NOPR, because NCPA is not one of the owners of the COTP.

Midway. Pacific Gas & Electric Company, 42 FERC para. 61,406, order on reh'g, 43 FERC para. 61,403 (1988). On February 22, 1988, PG&E advised NCPA that all firm transmission service available at Midway had **[31,923]** been fully subscribed. NCPA 1988 Complaint, Ex. 6. Then, on March 29, 1988, PG&E filed with the Commission an interconnection agreement with Modesto Irrigation District (MID), that provided MID with 50 MW of bi-directional transmission at Midway. Pacific Gas & Electric Company, 44 FERC para. 61,010 (1988). At about the same time (in the last week in March 1988), PG&E advised NCPA that the allocations of transmission to TID, MID, and others, including a not yet finalized allocation to Sacramento Municipality Utility District, had used all the transmission available at Midway. NCPA 1988 Complaint, Exs. 7 and 8.

D. *Northeast Utilities Service Company (NU)*

This is the case where Northeast Utilities acquired Public Service of New Hampshire (PSNH) (Docket No. EC90-10). New England Power Company (NEP) witness Robert Bigelow's direct testimony expressed concern over the "relatively restrictive transmission policies of both" NU, on behalf of Northeast Utilities' public utility subsidiaries, and PSNH. Bigelow Direct Testimony at 21 (filed May 25, 1990). In his cross rebuttal testimony, Mr. Bigelow testified that "NU has a poor track record as a provider of transmission service" and "PSNH also has an abhorrent track record as a provider of transmission services." Bigelow Cross Rebuttal Testimony, at 3 (filed June 20, 1990). Mr. Bigelow described both NU's and NEP's (his own company) failure to provide service flexibility equivalent to their own use. Except for NEP's TDUs, both NEP and NU historically provided only

point-to-point transmission, which required separate scheduling for each transaction. Bigelow Cross Rebuttal at 4.

E. *Southern California Edison Company and San Diego Gas and Electric Company*

The evidence in this merger proceeding (Docket No. EC89-5) included testimony from a number of witnesses describing instances of Edison's conduct. Richard Greenwalt was the power supply supervisor for the City of Riverside, California. He was responsible for scheduling all purchases of energy for Riverside and for the cities of Azusa, Banning and Colton, California. Greenwalt testimony at 1 (November 1989). (These four cities and Anaheim, California, are collectively referred to as the Southern Cities or Cities.) Joseph Hsu was the Director of Utilities for Azusa. Hsu testimony at 1 (November 1989). Gale Drews was the electric utility director of Colton. Drews testimony at 1-2 (November 1989). Bill Carnahan was the director for Riverside. Carnahan testimony at 1 (November 1989). Gordon Hoyt was the general manager of the Anaheim power department. Hoyt testimony at 1 (November 1989). Dan McCann was the power coordination supervisor for Anaheim. He supervised Anaheim's load scheduling and is a former Edison employee, having worked for Edison for 20 years. McCann Testimony at 1-2 (November 1989). These witnesses testified that Edison refused to wheel as follows.

1. Edison's policy was to curtail the Cities any time it could be justified using any of a list of acceptable reasons to deny interruptible transmission service. Id. at 22-23.

2. Edison would not generally provide transmission service when Edison could save money by itself purchasing the economy energy that would be wheeled. McCann testimony at 19. The Cities called Edison every hour to request interruptible transmission service. Id.. Edison often refused to sell energy available in the Western Systems Power Pool to the Cities and then made available higher cost contract energy or partial requirements service. Id. at 19-20.

3. When Anaheim requested Edison provide firm transmission of power from neighboring states, Edison would often agree to provide non-firm service but would not integrate the capacity for many years in the future, saying that its control area did not need capacity at that time. Hoyt testimony at 9. Since the selling utility was interested in a sale of capacity, not just energy, the transaction would not occur. Id. Edison repeatedly used its control over transmission to deny Anaheim access to low-cost firm power. Id. at 9-10.

4. While Edison provided short-term firm transmission service to the Cities, it would only provide long-term firm service for three specific resources: The SONGS nuclear plant, a specific IPP, and Hoover Dam power. Hoyt testimony at 20. One of Edison's reasons for denying long-term transmission was that Edison desired to **[31,924]** reserve the transmission for its own future (unspecified) needs. Id.

5. In the 1970s, Edison refused to allow the Cities access to the Pacific Intertie. Hoyt testimony at 21; Drews testimony at 7-8.

6. In 1988, Edison refused to provide transmission service for a Cities power purchase from Public Service

Company of New Mexico (PSNM) from Palo Verde Nuclear station. Hoyt testimony at 21.

7. Edison has refused to provide requested firm transmission from

--California-Oregon border to Midway Station

--Nevada-Oregon Border to Sylmar Substation

--Palo Verde Switchyard to Vista

--SONGS Switchyard to Vista.

Carnahan testimony at 15.

8. Riverside requested transmission from Palo Verde and was told that such service was not available. Carnahan testimony at 16. Edison offered Riverside only 12 MW of curtailable transmission entitlement to provide Riverside's share of Palo Verde. Id. This service was neither large enough or long enough, and Edison insisted on unreasonable terms and conditions. Id.

9. Azusa, Banning and Colton had a contract with Edison that entitled them to use their Palo Verde firm transmission path to schedule energy to meet their contract energy obligation. Edison refused to permit the three cities to use that path. Edison did not contest that the contracts allowed this use, but said that the scheduling of such small amounts of energy for the three cities would be too burdensome. Greenwalt testimony at 14.

10. Edison would not respond in a timely manner to the Cities' requests, routinely taking months to respond. Drews testimony at 15.

11. During the 1980s, Edison provided Colton with some transmission service to allow the Cities to reach certain suppliers, but limited the choices available to the Cities and imposed terms and conditions that increased the Cities' costs and placed Colton at a disadvantage against Edison. Drews testimony at 9. Arranging alternative generation sources was difficult because the Cities always had to first get Edison to state whether it would provide transmission.

12. During 1988 and 1989, a dispute arose between Edison and the Cities concerning the Hoover Uprating Project. Drews testimony at 16. Edison argued that for the months when units were out of service for uprating, and Southern Cities capacity was reduced to zero, Southern Cities would not receive an energy credit, even though energy was still available and used by Edison. But the contracts allowed a participant who did not have capacity to still schedule its energy as non-firm energy on the capacity of another participant. Id. at 16-17.

13. In 1986, Azusa negotiated a power purchase contract with the California Department of Water Resources in increments of first 5 MW and then 2 MW (for a total of 7 MW). Hsu testimony at 14. First Edison assured Azusa that the transmission for the additional 2 MW would not be a problem. Id. Then Edison would not agree to amend the transmission service agreement for the additional 2 MW. Id.

14. In 1986, Azusa notified Edison of Special Condition 12[4] purchases from PG&E and requested firm transmission service. Id. Two months before service was to begin, Edison notified the Cities of a problem with the transmission lines. Id. Transmission was eventually granted, but only after a four-month delay and substantial losses to the Cities. Id. Then Edison decided there was no problem with its transmission facilities. Id. at 14-15.

15. In 1986-87, the Cities purchased 20 MW from PG&E and 80 MW from Deseret G&T Cooperative. Hoyt testimony at 7-8. Edison stated that without reinforcement of its transmission system, Edison would not provide the transmission. Id. There was a five-month delay during which the Cities were forced to purchase from Edison at a higher cost. Id. at 8-9. Then Edison decided that the transmission system did not need reinforcement. Id. at 8.

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16. Edison also refused to provide a service priority equal to that of native load. It would curtail the Cities in order to purchase more economy energy for itself. McCann testimony at 28. If Edison could make the purchase, it would curtail the City and use the energy for itself. Id. When Edison curtailed the Cities, they were not able to purchase economy energy and instead purchased energy from Edison. Id. at 24.

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[4]Special Condition 12 of the Integrated Operations Agreement between Edison and the Southern Cities defined certain Special Condition 12 resources and allowed the Cities to make certain uses of those resources, subject to certain restrictions.

17. According to Edison, the interruptible transmission it provided the Cities was interruptible for any reason. Id. at 20. A purchase could be terminated the hour after it is begun or even during the hour. Id. As a result, the Cities lost opportunities to make advantageous economy purchases. Id. at 20-21.

18. Edison also refused to provide customers flexibility similar to the flexibility Edison provided itself. Edison's refusal to provide bi-directional transmission service restricted the Cities' abilities to purchase hydroelectric energy from the Pacific Northwest. Hoyt testimony at 22. Because most contracts with Northwest utilities require a return of power, the Northwest utilities would not deal with the Cities without transmission to return energy. Id. at 22-23. Edison did provide bi- directional transmission to the Los Angeles Department of Water & Power (LADWP) to accommodate flows to and from Arizona. Id.

19. Riverside was unable to obtain non-firm service more than two hours in advance of need. Carnahan testimony at 18.

20. Riverside and Colton were both served out of Edison's Vista substation. Although the two cities were on the same 69 kV bus, Edison would not allow them to sell energy to each other. Greenwalt testimony at 17.

21. Riverside's agreement with Edison allowed Riverside to purchase a block of energy through the WSPP and divide it up among the four Cities (Azusa, Banning, Colton and Riverside). Greenwalt testimony at 17. When Riverside had excess energy from other sources, Edison

would not permit it to sell that energy to the other three cities. Id. For example, Riverside attempted to sell Deseret energy transmitted by LADWP to the Edison system. Id. at 17-18. LADWP would not break out the Cities' shares of that energy, and Edison would not accept the energy as a delivery for all four cities. Id. at 18. Edison argued that because this energy was excess energy that Riverside could not use, Riverside did not have transmission rights to bring it into the control area. Id. As a result, Riverside paid for the energy delivered by LADWP to the Edison control area, but could not sell it to the other three cities, and gave it to Edison itself, which consumed the energy without making any payment for it. Id. Riverside tried a number of alternative paths, including using WSPP transmission where Riverside paid Edison 5 mills to connect to Azusa, 5 mills to connect to Banning, and 5 mills to connect to Colton for each megawatthour. While this approach was successful for a while, eventually Edison refused to permit these sales.

22. Edison claimed that the Cities only have transmission rights to bring in enough Special Condition 12 energy to satisfy the Cities' load. Greenwalt testimony at 18.

23. Edison contended that the Cities' load requirements were satisfied first by integrated resources and then by Special Condition 12 and economy energy purchases. Id. at 19. When the Cities' integrated resources exceeded their load, any Special Condition 12 resources became excess. Under Riverside's Deseret contract, the Cities were required to take a minimum of 35 MW each hour. Id. Edison acknowledged that it was obligated to buy, or allow the Cities to sell, any excess energy from Riverside's integrated resources. Id. However, Edison refused to give the Cities

credit for excess Special Condition 12 energy brought into the area, claiming that the Cities could not have brought it in because they did not have transmission rights. Id.

II. Other Examples of Transmission Disputes

Disputes over transmission are not uncommon, contrary to EEI's suggestion. Some recent examples taken from pleadings and other documents and from Commission orders reveal that it has been very difficult for various entities in the electric power industry to agree on transmission rights. These examples also reveal that even after issuance of AEP and the Open Access NOPR with its proposed pro forma tariffs, there has been considerable controversy over whether various utilities' **[31,926]** "open access" tariffs deviate from those tariffs. (The Commission has allowed utilities that adopt tariffs that match or exceed the non-rate terms and conditions in the NOPR pro forma tariffs to obtain certain benefits.)

A. In a letter of February 3, 1995 to Mr. Gerald Richman of the Commission's Enforcement section in the Office of the General Counsel, Steven J. Kean, Vice President, Regulatory Affairs, Enron Power Marketing, Inc. (Enron) alleged that Niagara Mohawk Power Corporation (NiMo) refused to wheel power from Rochester Gas & Electric (RG&E) to Enron under RG&E's transmission contract with NiMo; however, when Enron revealed the buyer, NiMo did wheel power for RG&E to the buyer. Mr. Kean alleged that this was not an isolated incident. NiMo argued that the contract did not require it to provide RG&E with transmission to Enron. It also said that the principle of comparability does not require the service. Letter of

November 21, 1994 from NiMo representative A. Karen Hill to Gerald Richman.

B. The Commission's Task Force Hot Line (Hot Line) received a complaint that a member of the New York Power Pool (NYPP) refused to transmit power that another member bought from a power marketer. In a letter of November 17, 1994, from Chair Moler to Mr. William J. Balet, Executive Director of NYPP, Chair Moler explained that the Commission's enforcement staff had investigated and found the allegation to be true.

C. In Southern Minnesota Municipal Power Agency v. Northern States Power Company (Minnesota), 73 FERC 61,350 (1995), NSP and SMMPA had a contract under which NSP agreed to provide transmission service. However, the parties had numerous disputes over the service. The Commission found that NSP had misinterpreted the contract in several ways. For, example, SMMPA argued that it should be able to directly schedule its deliveries of energy out of the NSP control area and that it should not be limited to particular points of delivery. NSP argued that only it was entitled to control the physical operation of scheduling. The Commission found that the clear language of the contracts gave SMMPA the authority to schedule its own power.

D. Mid-Continent Area Power Pool, 72 FERC para. 61,223 (1995), involved MAPP's membership criteria, which made it impossible for a power marketer to join MAPP and obtain the benefits of certain transmission services available only to MAPP members. The Commission found that the membership criteria may be unreasonable, particularly since

there may be less burdensome ways of setting up membership criteria for non-traditional entities.

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[pp. 31,966 - 31,981]

[31,966]

APPENDIX G

I. Legal Analysis of Commission Jurisdiction Over the Rates, Terms and Conditions of Unbundled Retail Transmission in Interstate Commerce

Based on an analysis of the relevant legislative history and case law under the Federal Power Act (FPA), the Commission concludes that it has exclusive jurisdiction over the rates, terms and conditions of the unbundled transmission in interstate commerce, by a public utility, of electric energy to an end user. This is also known as retail wheeling in interstate commerce.[1]

The Commission's jurisdiction over the rates, terms and conditions of transmission in interstate commerce derives

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[1]Section 212(h) of the FPA provides that no order issued under the FPA shall be conditioned upon or require the transmission of electric energy directly to an ultimate consumer. 16 U.S.C. §824k(h). The Commission's assertion of jurisdiction in this final rule is over the rates, terms and conditions of retail transmission that occurs voluntarily or as a result of a state retail access program.

from Congress' power to regulate interstate commerce under the United States Constitution[2] and the FPA. When Congress enacted the FPA, it gave the Commission exclusive jurisdiction over the rates, terms and conditions of transmission in interstate commerce by public utilities. The Supremacy Clause of the Constitution provides that federal laws enacted pursuant to the powers delegated to the federal government by the United States Constitution are the supreme law of the land.[3] Accordingly, to the extent that retail wheeling involves transmission in interstate commerce by public utilities, the rates, terms and conditions of such service are subject to the exclusive jurisdiction of the Commission, and must be filed with the Commission.[4]

1. Relevant Federal Power Act Provisions

Section 201(b)(1) of the FPA provides:

The provisions of this Part shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce * * *. The Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction * * * over facilities used in local distribution or only for the transmission of electric energy in

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[2]U.S. Const. art I, Section 8, cl.3.

[3]U.S. Const. art. VI, cl.2.

[4]*See Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246, 251-52 (1951) (*Montana-Dakota*).

interstate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter.

16 U.S.C. 824(b)(1) (emphasis added). Thus, the statute on its face limits Commission jurisdiction over sales of energy to sales at wholesale, but does not limit jurisdiction **[31,967]** over transmission to transmission used only for wholesale sales.

Sections 201(c) and (d) define the meaning of "the transmission of electric energy in interstate commerce" and "sale of electric energy at wholesale in interstate commerce." Section 201(c) provides:

For the purpose of this Part, electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof: but only insofar as such transmission takes place within the United States.

16 U.S.C. 824(c). Section 201(d) provides:

The term "sale of electric energy at wholesale" when used in this Part means a sale of electric energy to any person for resale.

16 U.S.C. 824(d).

Sections 205 and 206 of the FPA give the Commission jurisdiction over the rates, terms and conditions of transmission in interstate commerce, and sales at wholesale in interstate commerce, by public utilities. 16 U.S.C. 824d and 824e.

2. Legislative History and Case Law

Much of the legislative history of the FPA indicates that Congress intended the Commission's jurisdiction to extend only to those matters which the Attleboro decision[5] held to be beyond the reach of the States. For instance, the report accompanying the Senate bill states that subsection (b) "leaves to the States the authority to fix local rates even in cases where the energy is brought in from another State."[6] In other words, states retain authority to regulate rates of electric energy to ultimate consumers. The Senate report also states:

The rate-making powers of the Commission are confined to those wholesale transactions which the Supreme Court held in (Attleboro) to be beyond the reach of the States. Jurisdiction is asserted also over all interstate transmission lines whether or not there is sale of the energy carried by those lines and over the generating facilities which produce energy[7] for interstate transmission and sale.

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[5]*Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927) (Attleboro). In Attleboro, the Supreme Court held that State regulation of the interstate sale of electricity was barred by the Commerce Clause because such regulation would impose a "direct burden" on interstate commerce.

[6]S. Rep. No. 621, 74th Cong., 1st Sess. 48 (1935). See also H.R. Rep. No. 1318, 74th Cong., 1st Sess. 8 (1935).

[7]The provisions of the Senate bill regarding federal jurisdiction over generating facilities were eliminated from the final version of the bill.

S. Rep. No. 621, 74th Cong., 1st Sess. 48 (1935) (emphasis added). Thus, federal jurisdiction over transmission lines is not dependent on whether those lines are used to effect a sale, wholesale or otherwise.

The provisions of FPA section 201 reserving certain regulatory authority to the States have been interpreted narrowly.[8] The Supreme Court has stated:

In section 201(b), Congress did no more than leave standing whatever valid state laws then existed relating to the exportation of hydroelectric energy; by its plain terms, 201(b) simply saves from pre-emption under Part II of the Federal Power Act such state authority as was otherwise "lawful."[9]

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[8]Section 201(a) declares that Federal regulation of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, "such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States." 16 U.S.C. §824(a). Section 201(b)(1) states that the provisions of Part II of the FPA apply to the transmission of electric energy in interstate commerce and the sale of electric energy at wholesale in interstate commerce but, except as specifically provided, "shall not apply to any other sale of electric energy or deprive a State or State commission of its lawful authority now exercised over the exportation of hydroelectric energy which is transmitted across a State line." 16 U.S.C. §824(b)(1).

[9]*New England Power Co. v. New Hampshire*, 455 U.S. 331, 341 (1982) (NEPCO).

The Court also stated:

Nothing in the legislative history or language of the statute evinces a congressional intent 'to alter the limits of state power otherwise imposed by the Commerce Clause,' * * * or to modify the earlier holding of this Court concerning the limits of state authority to restrain interstate trade.[10]

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Unlike the narrow interpretations given to the FPA provisions reserving certain regulatory authority to the States,[11] the courts have construed transmission "in interstate commerce" broadly. The term does not turn on whether the contract path for a particular power or transmission sale crosses state lines, but rather follows the physical flow of electricity. Because of the highly integrated nature of the electric system, this results in most transmission of electric energy being "in interstate commerce."

One of the earliest cases construing Commission jurisdiction over transmission was Jersey Central Power & Light Co. v. FPC, 319 U.S. 61 (1943) (Jersey Central). In that case, the Commission asserted jurisdiction over a New

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[10] *Id.* (citation omitted).

[11] While Congress may exercise its Commerce Clause authority to grant the States that "ability to restrict the flow of interstate commerce that they would not otherwise enjoy," Lewis v. BT Investment Managers, Inc., 447 U.S. 27, 44 (1980), States may not exercise such regulatory powers unless Congress has expressly stated its intention to make such an affirmative grant of power. *NEPCO*, 455 U.S. at p. 343.

Jersey utility by showing that the utility owned transmission facilities that were used to transmit energy in interstate commerce. The Court found that the Commission had demonstrated that the utility owned transmission facilities that were indirectly interconnected, through a second New Jersey utility, to facilities owned by a New York utility and that the facilities were used to transmit electric energy in interstate commerce.

The Court noted that section 201(c) of the FPA defines electric energy transmitted in interstate commerce to be energy "transmitted from a State and consumed at any point outside thereof." The Court stated:

It is impossible for us to conclude that this definition [of transmission in interstate commerce] means less than it says and applies only to the energy at the instant it crosses the state line and so only to the facilities which cross the line and only to the company which owns the facilities that cross the line.

319 U.S. at 71. Thus, a critical question regarding the jurisdictional status of a wheeling transaction is whether the facilities used to provide the service transmit electric energy in interstate commerce.

In Connecticut Light & Power Co. v. FPC, 324 U.S. 515 (1945) (CL&P), the Court reviewed the Commission's finding that a Connecticut utility was jurisdictional because it owned transmission facilities that were used in interstate commerce. The Court generally embraced the Jersey Central standard for determining whether facilities are used to transmit electric energy in interstate commerce. The Court

emphasized that whether certain facilities transmit electric energy in interstate commerce is more a technical than a legal question. The Court stated:

> Federal jurisdiction was to follow the flow of electric energy, an engineering and scientific, rather than a legalistic or governmental, test.

324 U.S. at 529. Thus, the Court adopted the Jersey Central test providing that the Commission's jurisdiction generally extends to transmission facilities that transmit electric energy in interstate commerce.

The Court also applied the Jersey Central test in FPC v. Florida Power & Light Co., 404 U.S. 453 (1972), affirming the Commission's finding of jurisdiction over a Florida utility. The Commission demonstrated that the utility transmitted power to another Florida utility's "bus"[12] that power was simultaneously transferred from the "bus" to a Georgia utility. The Court upheld the Commission's finding that electric energy from the two Florida utilities was commingled and was therefore transmitted in interstate commerce. 404 U.S. at 463.

In all of the above cases, the Court's decisions turned on whether energy being transmitted flowed in interstate commerce as a technical matter. The decisions did not turn on

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[12]A bus is an electrical conductor which serves as a common connection for two or more electrical circuits. Electric Utility Rate Design Study, Glossary: Electric Utility and Ratemaking Load & Management Terms, Edison Electric Institute (Sept. 11, 1978).

whether the transmission of energy flowing in interstate commerce involved energy that was being sold for resale or was being sold to **[31,969]** an end user. Thus, there is nothing in the statute, its legislative history, or the case law to indicate that the Commission's jurisdiction over rates, terms and conditions of transmission in interstate commerce extends only to wholesale transmission and not retail transmission. Indeed, the statute on its face gives the Commission jurisdiction over transmission in interstate commerce and makes no distinction between wholesale transmission and retail transmission.

However, there are two important limitations on Commission authority. First, as discussed above, the FPA does not give the Commission jurisdiction over sales of electric energy at retail. Such sales historically have been bundled sales (i.e., generation and transmission), and courts and the Commission have recognized State jurisdiction over bundled sales of energy. Second, under section 201(b)(1) of the FPA, the Commission does not have jurisdiction over facilities used in local distribution. In CL&P, the Court stated that local distribution facilities are exempt from Commission jurisdiction even if those facilities "carry no energy except extra-state energy." 324 U.S. at 531.

In the next section the Commission further discusses the statutory provisions and case law that shed light on the demarcation between transmission and local distribution, and thus on the jurisdictional line between federal and State authority.

II. Legal Analysis of Commission Jurisdictional Transmission Facilities and State Jurisdictional Local Distribution Facilities

Two specific circumstances are addressed:

First, what facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to a purchaser who will then re-sell the energy to an end user?

Second, what facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to an end user?

Based on an analysis of the relevant legislative history and case law under the FPA, the Commission reaches the following conclusions. With respect to the first circumstance, the Commission concludes that a public utility's facilities used to deliver electric energy to a wholesale purchaser, whether labeled "transmission," "distribution," or "local distribution" are subject to the Commission's exclusive jurisdiction under sections 205 and 206 of the FPA, and that a public utility's facilities used to deliver electric energy from the wholesale purchaser to the ultimate consumer are "local distribution" facilities subject to the rate jurisdiction of the state.[13]

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[13]There are, of course, facilities that are used to provide delivery to both wholesale purchasers and end users. In those situations, we believe that the Commission and the States have

With respect to the second circumstance, the Commission believes that, based on the particular facts of the case, some of the public utility's facilities used to deliver electric energy to an end-user may be FERC-jurisdictional transmission facilities, while some of the facilities used may be state-jurisdictional local distribution facilities.

We set forth below the relevant legislative history and case law, our legal conclusions, and the factors which we believe are indicative of whether facilities are used in "local distribution" or "transmission in interstate commerce," as those terms are used in the FPA.

1. Relevant Federal Power Act Provisions

The Commission's jurisdiction is set forth in section 201 of the FPA.[14] Section 201(b)(1) provides in pertinent part:

The provisions of this Part shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce * * *. The Commission shall have jurisdiction over all facilities for **[31,970]** such transmission or sale of electric energy, but shall not have jurisdiction * * * over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for

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jurisdiction to set rates for the services that are within their respective jurisdictions. That facilities are used to serve resale and retail customers does not, however, necessarily mean that the facilities are local distribution facilities.

[14]16 U.S.C. §824.

the transmission of electric energy consumed wholly by the transmitter.[15]

Some of the court decisions that construe jurisdictional facilities under section 201 also construe the Commission's jurisdiction under section 203. Section 203(a) provides, in relevant part:

No public utility shall sell, lease, or otherwise dispose of the whole of its facilities subject to the jurisdiction of the Commission, * * * or by any means whatsoever, directly or indirectly, merge or consolidate such facilities or any part thereof with those of any other person * * * without first having secured an order of the Commission to do so.[16]

In addition, section 206(d) concerns facilities "under the jurisdiction of the Commission":

The Commission upon its own motion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.[17]

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[15]16 U.S.C. §824(b) (emphasis added).

[16]16 U.S.C. §824b (emphasis added).

[17]16 U.S.C. §824e(d) (emphasis added).

2. Legislative History of the FPA

The relevant legislative history of the general purposes of Title II of the FPA, and of section 201 in particular, focuses primarily on bundled sales of electric energy and does not directly address the issue of what constitutes local distribution as opposed to transmission in interstate commerce.

In discussing the general purposes of Title II of the House bill, the House Report states:

Title II * * * establishes for the first time regulation of electric utility companies transmitting energy in interstate commerce.

* * * * *

* * * Under the decision of the Supreme Court of the United States in (Attleboro), the rates charged in interstate wholesale transactions may not be regulated by the States. Part II gives the Federal Power Commission jurisdiction to regulate these rates. A "wholesale" transaction is defined to mean the sale of electric energy for resale and the Commission is given no jurisdiction over local rates even where the electric energy moves in interstate commerce.[18]

[18]H.R. Rep. No. 1318, 74th Cong., 1st Sess. 7-8 (1935).

In its analysis of section 201, the House Report states:

As in the Senate bill no jurisdiction is given over local distribution of electric energy, and the authority of States to fix local rates is not disturbed even in those cases where the energy is brought in from another State.[19]

The Senate Report's discussion of the general purposes of the FPA states:

The decision of the Supreme Court in [Attleboro] placed the interstate wholesale transactions of the electric utilities entirely beyond the reach of the States. Other features of this interstate utility business are equally immune from State control either legally or practically.[20]

In discussing material differences between the final version of the Senate bill and the original version, the Senate Report states:

Subsection (b), formerly (a), which states the subject matter to which the part relates, has been clarified to make plain that it includes interstate transmission where there is no sale and excludes **[31,971]** all facilities used only for

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[19]*Id.* at p. 27.

[20]S. Rep. No. 621, 74th Cong., 1st Sess. at p. 17 (1935). See id. at p. 18 ("The revision [between the original and final versions of the Senate bill] has also removed every encroachment upon the authority of the States. The revised bill would impose Federal regulation only over those matters which cannot effectively be controlled by the States.")

production of transmission in intrastate commerce or in local distribution.[21]

In discussing section 201 of the Senate bill, the Senate Report further states:

The rate-making powers of the Commission are confined to those wholesale transactions which the Supreme Court held in (Attleboro) to be beyond the reach of the States. Jurisdiction is asserted also over all interstate transmission lines whether or not there is sale of the energy carried by those lines and over the generating facilities which produce energy for interstate transmission and sale. It is obvious that no steps can be taken to secure the planned coordination of this industry on a regional scale unless all of the facilities, other than those used solely for retail distribution, are made subject to the jurisdiction of the Commission. Facilities used only for intrastate commerce or local distribution are expressly excluded from the operation of the act.[22]

The Conference Report adds little description regarding jurisdictional facilities. In reference to section 201(b) it states that:

[T]he language of the House amendment has been followed with a clarifying phrase added to remove any doubt as to the Commission's jurisdiction over facilities used for the

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[21] *Id.* at p. 19.

[22] *Id.* at p. 48. The provisions of the Senate bill regarding federal jurisdiction over generating facilities were eliminated from the final version of the bill.

generation and local distribution of electric energy to the extent provided in other sections of this part and the part next following.[23]

In addition to the above statements pertaining to section 201 of the FPA, Congress referenced distribution of energy in the legislative history of section 206(d). Section 206(d) was originally enacted as section 206(b) of the FPA. Under the Regulatory Fairness Act of 1988,[24] section 206(b) was redesignated as section 206(d).

The Conference Report on the original FPA does not address section 206(b). The Senate Report on the FPA bill states in pertinent part:

Subsection (b) authorizes the Commission to investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy. * * * Since the rate-making powers granted to the Commission apply only to the wholesale rates of energy sold in interstate commerce, this last subsection should be of great benefit in removing the practical difficulty which the States may encounter in regulating the interstate distribution rates which are left under their control. Such rate regulation involves the examination and valuation of property outside the State. The task is one requiring an agency with a

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[23]H.R. Conf. Rep. No. 1903, 74th Cong., 1st Sess. 74 (1935).

[24]Pub. L. No. 100-473, 102 Stat. 2299 (1988).

jurisdiction broader than that of a single State. The authority of the Federal Commission is to render assistance to the State commissions in a way which would preserve and make more effective the jurisdiction which is thus left to the States.[25]

The House Report discusses section 206(b) as follows:

This subsection reaches those situations where electric energy is transmitted in interstate commerce by the same company which distributes it locally, and will greatly aid State commissions in fixing reasonable rates in such cases.[26]

Thus, the discussions in the two reports do not appear to contemplate a situation in which the transmitter and seller of electric energy are different, and neither is a "local" distributor. The House Report expressly refers to the same company being the transmitter and seller of electric energy. The Senate Report by its terms addresses the regulation of interstate distribution rates.[27]

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[25]S. Rep. No. 621, 74th Cong., 1st Sess. 51 (1935) (emphasis added).

[26]H.R. Rep. No. 1318, 74th Cong., 1st Sess. 29 (1935) (emphasis added).

[27]The Senate Report states that interstate distribution rates are left in the States' control. Obviously, the Senate drew a distinction between interstate distribution (left in the States' control) and interstate transmission (given to the FPC). Compare S. Rep. No. 621 at p. 49 with H.R. Rep. No. 1318 at p. 51.

The above legislative history on sections 201 and 206(b) does not provide any **[31,972]** definitive answers to the questions raised. We therefore turn to the case law under the FPA.

3. Case Law Under the FPA

Jersey Central was the first of the major FPC jurisdictional cases considered by the Supreme Court. The case involved the acquisition by New Jersey Power and Light Company (New Jersey Power) of certain securities of Jersey Central Power & Light Company (Jersey Central) without the Commission's prior approval. The question before the Court was whether Jersey Central was a "public utility" under section 201(e)[28] of the FPA so that the Commission's prior approval of the stock acquisition was necessary under section 203 of the FPA.

Jersey Central owned transmission facilities that connected to facilities that Public Service Electric & Gas Company (Public Service) owned. The interconnection of these transmission facilities was in New Jersey. Public Service's facilities in turn connected to the facilities of the Staten Island Edison Corporation (Staten Island Edison), a New York utility, at the mid-channel of Kill van Kull, a body

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[28]Section 201(e) defines a "public utility" as "any person who owns or operates facilities subject to the jurisdiction under this Part (other than facilities subject to such jurisdiction solely by reason of section 210, 211, or 212)." 16 U.S.C. §824(e). The section as adopted in 1935 did not contain the parenthetical, which was adopted in 1978 as part of the Public Utility Regulatory Policies Act.

of water separating New Jersey and New York. Jersey Central delivered energy to and received energy from Public Service under contract, and Public Service delivered energy to and received energy from Staten Island Edison under contract.[29]

The Court found that, although Jersey Central generated and received electricity only in New Jersey, some of the electric energy that it dispatched to Public Service "was instantaneously transmitted to New York."[30] The Court held that "[t]his evidence * * * furnishes substantial basis for the conclusion of the Commission that facilities of Jersey Central are utilized for the transmission of electric energy across state lines."[31] Therefore, the Court found that Jersey Central was a public utility within the meaning of section 201(e).[32]

The Court cited Attleboro, in which the Court found that the sale of locally produced electric energy for use in another state resulted in the transmission of electric energy in interstate commerce, even though title passed at the state line.[33] In Jersey Central, the Court explained the rationale for federal jurisdiction as follows:

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[29]Jersey Central, 319 U.S. at pp. 63-65.

[30]*Id.* at p. 66.

[31]*Id.* at p. 67 (citation omitted).

[32]*Id.* at p. 73.

[33]273 U.S. at pp. 86, 89-90.

(Section 201(c) of the FPA) defines the electric energy in commerce as that "transmitted from a State and consumed at any point outside thereof." There was no change in this definition in the various drafts of the bill. The definition was used to "lend precision to the scope of the bill." It is impossible for us to conclude that this definition means less than it says * * *. The purpose of this act was primarily to regulate the rates and charges of the interstate energy.[34]

The Court in Jersey Central thus interpreted the FPA as placing within the federal province regulation of wholesale sales of electric energy that, in any manner, flows in interstate commerce. The language quoted above and the citation to section 201(c) of the FPA, to be relied upon in subsequent Supreme Court cases, strongly suggested that the Commission's jurisdiction was not based on whether there was a sale by the utility, but rather on the flow of electric energy either into or out of a state, so long as the energy crosses state lines.

CL&P, which was decided two years after Jersey Central, is the leading case interpreting the section 201(b) local distribution proviso. In CL&P, the Commission sought to regulate the accounting practices of Connecticut Light & Power Company (CL&P).[35] At issue was whether **[31,973]** CL&P was a "public utility" under the FPA. The utility's system encompassed an area solely within a single state

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[34]319 U.S. at p. 71 (footnote omitted).

[35]CL&P, 324 U.S. at p. 517.

(Connecticut)[36] and did not interconnect with any other company that operated out of state.[37] "Its purchases and sales, its receipts and deliveries of power, [were] all within the state."[38] However, CL&P did purchase energy from companies that had, in turn, purchased energy from Massachusetts. The company also sold energy to a municipality that exported a portion of that energy to Fishers Island, located off the coast of Connecticut but "territory of New York."[39] The Commission based its jurisdiction on these few transactions.[40]

The Court of Appeals affirmed the Commission, holding that the Commission's jurisdiction extended to "electric distribution systems which normally would operate as interstate businesses." The Court of Appeals found that:

Whether or not the facilities by which petitioner distributes energy from Massachusetts should be classified as 'local' is not relevant to this case. The sole test of jurisdiction of the Commission over accounts is whether these facilities,

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[36] *Id.* at p. 518.

[37] *Id.* at p. 521.

[38] *Id.* at p. 522.

[39] *Id.* at pp. 519-21.

[40] *Id.*

'local' or otherwise, are used for the transmission of electric energy from a point in one state to a point in another.([41])

The Supreme Court reversed. It held that the statutory language in section 201(b) of the FPA providing that the Commission "shall not have jurisdiction * * * over facilities used in local distribution" is a limitation upon Commission jurisdiction that "the Commission must observe and the courts must enforce."[42] In analyzing the statute, the Court stated:

It has never been questioned that technologically generation, transmission, distribution and consumption are so fused and interdependent that the whole enterprise is within the reach of the commerce power of Congress, either on the basis that it is, or that it affects, interstate commerce, if at any point it crosses a state line.

* * * * *

But whatever reason or combination of reasons led Congress to put the provision in the Act, we think it meant what it said by the words "but shall not have jurisdiction * * * over facilities used in local distribution." Congress by these terms plainly was trying to reconcile the claims of federal and local authorities and to apportion federal and state jurisdiction over the industry.[43]

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[41] *Id.* at p. 522, *quoting Connecticut Light & Power Co. v. FPC*, 141 F.2d 14, 18 (D.C. Cir. 1944).

[42] 324 U.S. at p. 529.

[43] *Id.* at pp. 529-31.

The Court decided that this limitation on jurisdiction was "a legal standard that must be given effect in this case in addition to the technological transmission test."[44]

The Court stated that whether or not local distribution facilities carried out-of-state electric energy was irrelevant. Whatever the origin of the electric energy they carried, so long as the utility used the lines for local distribution,[45] they were exempt from federal jurisdiction.[46] In fact, the Court stated that local distribution facilities "may carry no energy except extra-state energy and still be exempt under the Act." Id. at 531. The Court concluded that the Commission's order:

> Must stand or fall on whether this company owned facilities that were used in transmission of interstate power and which were not facilities used in local distribution.[47]

Upon reversing the Court of Appeals, the Court commented, in dictum, on the evidence the Commission had relied upon in finding that the facilities in question were used for transmission. It noted that the Commission had relied upon certain gas transportation cases in concluding that transmission extends from the generator to the point where the

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[44]*Id.* at p. 531.

[45]It appears that while the Company received power (at one location) at 66 kV, it primarily owned facilities at 13.8 kV and below.

[46]324 U.S. at p. 531.

[47]*Id.* at p. 531 (emphasis added).

function of conveyance in bulk over distance is completed **[31,974]** and the process of subdividing the energy to serve ultimate consumers, which is the characteristic of "local distribution," is begun. The Court cautioned:

> But a holding that distributing gas at low pressure to consumers is a local business is not a holding that the process of reducing it from high to low pressure is not also part of such local business. In so far as the Commission found in these cases a rule of law which excluded from the business of local distribution the process of reducing energy from high to low voltage in subdividing it to serve ultimate consumers, the Commission has misread the decisions of this Court. No such rule of law has been laid down.[48]

The Court also noted in its dictum, however, that once a company is properly found to be a "public utility" under the Act, the fact that a local commission may also have jurisdiction does not preclude exercise of the Commission's functions. Id. at 533.[49] The Court instructed the lower court

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[48] *Id.* at p. 534.

[49] *See United States v. Public Utilities Commission of California*, 345 U.S. 295, 316 (1953) (Public Utilities Commission): Certainly the concrete fact of resale of some portion of the electricity transmitted from a state to a point outside thereof invokes federal jurisdiction at the outset, despite the fact that the power thus used traveled along its interstate route "commingled" with other power sold by the same seller and eventually directly consumed by the same purchaser-distributor.

See also Arkansas Power & Light Co. v. FPC, 368 F.2d

to remand the case to the Commission for a finding regarding whether the facilities in question were used in local distribution.[50]

The CL&P case was ultimately disposed of without the Commission having made a finding that the facilities were used in local distribution. While the Commission found that it was "extremely doubtful" that it could find that the facilities in question were not local distribution facilities, 6 FPC 104, 106 (1947), the Commission did not articulate a definition of local distribution facilities.

In Wisconsin-Michigan Power Co. v. Federal Power Commission,[51] the Seventh Circuit held that a utility was a jurisdictional public utility where it operated two divisions in Wisconsin and Michigan in a coordinated manner such that electric energy from one state was transmitted to the other, and vice versa, "in appreciable amounts by the power company and by it commingled with energy generated in the

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376, 383 (8th Cir. 1966) ("Where a company is in fact a public utility, all wholesale sales for resale in interstate commerce are subject to the provisions of sections 205 and 206 of the (FPA), regardless of the facilities used."). The Eighth Circuit further noted that the section 201(b) exemption applies to a company's status as a public utility and not to the Commission's jurisdiction over sales in interstate commerce for resale. *Id., citing Public Utilities Commission, Colton, infra, and Wisconsin-Michigan, infra.*

[50] *Id.* at p. 536.

[51] 197 F.2d 472 (7th Cir. 1952), cert. denied, 345 U.S. 934 (1953) (*Wisconsin-Michigan*).

two respective districts and then delivered to the [wholesale] customers * * *."[52] The court also rejected the notion that the energy changed its form or character when it was stepped down in voltage before it reached the wholesale purchasers.[53]

The court in Wisconsin-Michigan distinguished between transmission and local distribution by focusing on wholesale sales of electric energy versus retail sales ("local rates") of electric energy. It cited the House Report on the FPA, and characterized the legislative history as follows:

The legislative history, (H.R. Rep. No. 1318), 74th Cong., 1st Sess. pages 7, 8 and 27 (1935), discloses that the Congressional Committee intended that the provisions of the (FPA) should apply to the transmission of electric energy in interstate commerce, i.e., the sale of energy at wholesale in interstate commerce, but not to the retail sale of any such energy in local distribution; that the (FPA) left to the state the authority to fix local rates where the energy is brought in from other states, and that the rate making power of the [FPC] was to be confined to those wholesale transmissions which the Supreme Court had held in (Attleboro) to be beyond the reach of the state. Under that decision, said the committee, the rates **[31,975]** charged in interstate wholesale transactions could not

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[52] *Id.* at p. 474.

[53] *Id.* ("Obviously the energy thus transmitted in interstate commerce is not changed in form or in character except that the voltage is reduced to an extent consistent with efficient economic management and operation.").

be regulated by the states. It defined a wholesale transaction as the sale of electric energy for resale.[54]

The Seventh Circuit's characterization of the House Report seems to equate transmission of electric energy in interstate commerce with the sale of energy at wholesale in interstate commerce. However, this interpretation is at odds with both the plain words of the statute as well as the language of the House Report, both of which refer to transmission in interstate commerce separately from sales for resale in interstate commerce.[55] In addition, the Senate Report, which the Seventh Circuit did not mention, clearly recognized jurisdiction over all interstate transmission lines, whether or not a sale of energy is carried by those lines.[56]

The Wisconsin-Michigan court also cited analogous natural gas cases, stating that "[t]he question is essentially, when does interstate commerce transportation end and where

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[54]197 F.2d at p. 476 (emphasis added).

[55]See H.R. Rep. No. 1318 at p. 27. ("Subsection (b) confers jurisdiction upon the Commission over the transmission of electric energy in interstate commerce and the sale of electric energy in wholesale in interstate commerce * * *." emphasis added).

[56]See S. Rep. No. 621 at p. 48 ("Jurisdiction is asserted over all interstate transmission lines whether or not there is a sale of the energy carried by those lines * * *.").

do the local distribution facilities first become operative."[57] The court further stated that:

(U)pon delivery to (the wholesaler) local distribution begins when he resells. His sales and distribution at retail are clearly local in character, and constitute only local distribution; but at no point before delivery to him has been completed, has interstate transmission terminated. In other words, "facilities used in local distribution" means facilities used for making resale and distribution to consumers, jurisdiction over which is left to the states. It was only because of this conclusion that the Supreme Court said, [citation omitted], the Act "cut[s] sharply and cleanly between sales for resale and direct sales for consumptive uses." We think there is no ground for the position that local distribution includes any transmission occurring before the wholesaler who resells at retail is reached.[58]

The Seventh Circuit concluded that the sales for resale were made in interstate commerce; that local distribution had not begun; that the interstate character of the transmission persisted until delivery to the wholesaler; that, up to that point, no local distribution facilities were in operation and that, therefore, the sales were subject to Commission regulation.

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[57] 197 F.2d at p. 477.

[58] *Id.*, citing *FPC v. East Ohio Gas Co.*, 338 U.S. 464 (1950) (East Ohio).

In Federal Power Commission v. Southern California Edison Company (the Colton case),[59] the Supreme Court held that the FPA provides a clear line of demarcation between jurisdictional transactions and non-jurisdictional transactions. However, this case, too, involved bundled sales of electric energy. In the facts of the case, Southern California Edison Company (Edison) admitted that it was a public utility by virtue of owning two interstate transmission lines.[60] At issue was whether its sales of electric energy to the City of Colton, California, for resale to Colton's retail customers, were jurisdictional. Included in the electric energy that Edison sold to Colton was out-of-state electric energy from Hoover Dam.[61] The Commission ruled that the sale to Colton was a sale of electric energy at wholesale in interstate commerce subject to regulation under the FPA.[62] In upholding the Commission, the Court held that Edison's importation of out-

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[59]376 U.S. 205 (1964) (Colton).

[60]The Supreme Court noted that Edison's status as a public utility did not decide the question of whether the FPC could assert jurisdiction over the rates for the Edison-Colton sale. Id. at p. 208 n.3.

[61]*Id.* at p. 208, 209 & n.5.

[62]*Id.* at p. 208. *See Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375, 380 (1983) ("(Colton) held, among other things, that * * * a California utility that received some of its power from out-of-state was subject to federal and not state regulation in its sales of electricity to a California municipality that resold the bulk of the power to others.").

of-state electricity for resale to Colton sufficed to confer federal jurisdiction.

[31,976]

The Court, citing an earlier Supreme Court case,[63] characterized Congressional intent in the FPA:

(W)hat Congress did was to adopt the test developed in the Attleboro line which denied state power to regulate a sale "at wholesale to local distributing companies" and allowed state regulation of a sale at "local retail rates to ultimate consumers."[64]

The Court rejected the argument that FPC jurisdiction was confined to those interstate wholesale sales constitutionally beyond the power of state regulation by force of the Commerce Clause, and was to be determined on a case-by-case analysis of the impact of state regulation upon the national interest. The Court stated that in the FPA:

(C)ongress meant to draw a bright-line easily ascertained, between state and federal jurisdiction, making unnecessary such case-by-case analysis. This was done in the Power Act by making FPC jurisdiction plenary and extend[ed] it to all wholesale sales in interstate commerce except those

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[63] *Illinois Natural Gas Co. v. Central Illinois Public Service Co.*, 314 U.S. 498, 504 (1942).

[64] 376 U.S. at p. 214.

which Congress has made explicitly subject to regulation by the States.[65]

The Court held that "[t]here is no such exception covering the Edison-Colton sale."[66]

Parties in the Colton case had raised the question of whether jurisdiction over the Colton sale was prevented by the "local distribution" proviso of section 201(b). The Court stated that whether facilities are local distribution facilities is a matter for the Commission to decide in the first instance. Citing CL&P, supra, it stated:

Whether facilities are used in local distribution -- although a limitation on FPC jurisdiction and a legal standard that must be given effect in addition to the technological transmission test * * * -- involves a question of fact to be decided by the FPC as an original matter.[67]

The Court cited evidentiary support and the Commission's expertise in such matters in upholding the Commission's determination that certain facilities owned by Edison were used exclusively to effect the wholesale sale to Colton and not for local distribution. Such facilities included 12 kV lines that served an industrial customer, several lighted highway signs, a residence and a railroad section house before they reached the transformers in the Colton substation. The

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[65] *Id.* at pp. 215-216.

[66] *Id.* at p. 216 (footnote omitted).

[67] *Id.* at p. 210 n.6 (citation omitted).

FPC had held that those uses prior to the lines reaching the Colton substation did not transform the lines into local distribution facilities.[68]

In Duke Power Company v. Federal Power Commission (Duke),[69] the D.C. Circuit held that a public utility's acquisition of facilities used solely in local distribution, and which would continue to be used for local distribution, was beyond the Commission's jurisdiction under section 203. The case involved Duke Power Company's (Duke's) proposed acquisition of facilities owned by Clemson University (Clemson), which were used to distribute electricity off-campus to customers (primarily university personnel) in two South Carolina counties. Clemson purchased the power at wholesale from Duke. No one appeared to contest the conclusion that the 7 miles of distribution line and 418 service connections owned by Clemson were "local distribution" facilities.[70] Rather, the case turned on interpreting section 203 and whether it was intended to affect only acquisitions of jurisdictional facilities, or also to affect acquisitions of non-jurisdictional facilities. In interpreting section 203, however, the D.C. Circuit extensively analyzed and discussed the fundamental jurisdictional lines that Congress drew in section 201.

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[68] *Id.* at p. 210 n.6.

[69] 401 F.2d 930 (D.C. Cir. 1968) (Duke).

[70] Duke delivered power to Clemson at a distribution voltage of 4,160 volts. The step-down transformers by which the voltage was reduced, and the substations at which the delivery was effected, were owned by Duke. 401 F.2d at p. 931, n.8.

Citing to the CL&P case, the court in Duke stated:

The Act, as we have seen, effectuated federal control over the transmission and the sale at wholesale of electric energy in **[31,977]** interstate commerce, and established the Commission's regulatory power over public utilities engaging in either of these pursuits.[71]

However, quoting CL&P, the court further stated:

The expression "facilities used in local distribution" is one of relative generality. But as used in this Act it is not a meaningless generality in the light of our history and the structure of our government. We hold the phrase to be a limitation on jurisdiction and a legal standard that must be given effect in this case in addition to the technological transmission test.[72]

The court further rejected the Commission's concept that, in order to determine whether jurisdiction over any particular acquisition existed, the impact of local supervision be measured on a case-by-case basis. Quoting from Colton, the court stated:

[T]his "flexible approach" -- involving as it does the consideration, inter alia, of "the effect of the regulation upon the national interest in the commerce" -- has been flatly rejected as a technique for resolving jurisdictional conflicts

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[71]401 F.2d at pp. 938-39 (emphasis added, footnotes omitted).

[72]*Id.* (footnote omitted).

between the Commission and state bodies * * * We think that like the line "(i)t cut sharply and cleanly between sales for resale and direct sales for consumptive uses" to facilitate jurisdictional determinations in rate regulation, "Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction, making unnecessary such case-by-case analysis," in distributing regulatory power over the acquisition of facilities.[73]

The court rejected the Commission's argument that jurisdiction over the merger or consolidation of jurisdictional facilities with those of any other "person" under section 203 gave the Commission jurisdiction over Duke's acquisition. The court stated that the FPA reflects a policy "'that matters largely of a local nature, even though interstate in character, should be handled locally and should receive the consideration of local [officials] familiar with the local conditions in the communities involved.'"[74]

Federal Power Commission v. Florida Power & Light Company[75] is the last major court case to address the Commission's transmission jurisdiction. In this case, the Commission sought to impose its accounting rules upon

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[73]*Id.* at p. 949 (footnotes omitted).

[74]*Id.* at p. 936 (quoting from Hearings on H.R. 5423 before the House Committee on Interstate and Foreign Commerce, 74th Cong., 1st Sess. 393 (1935) (testimony of then-FPC Commissioner Seavey)).

[75]404 U.S. 453, *reh'g denied*, 405 U.S. 948 (1972) (*Florida Power & Light*).

Florida Power & Light Company (Florida Power & Light). The company's system lay solely within the borders of Florida and did not directly connect with any out- of-state utility.[76] The Commission held that Florida Power & Light did own facilities that transmitted electric energy in interstate commerce, but the Court of Appeals for the Fifth Circuit ruled that the Commission did not have substantial evidence to support its finding.

The Supreme Court reversed. The Supreme Court noted that Florida Power & Light was a member of the Florida Power Pool along with Florida Power Corporation (Florida Power Corp.).[77] In turn, Florida Power Corp. connected with Georgia Power Company (Georgia Power) at a "bus"[78] south of the Georgia-Florida border.[79] Florida Power Corp. regularly exchanged power with Georgia Power.[80] In many instances, Florida Power Corp. transferred power to Florida Power & Light instantly after receiving power from Georgia Power, and transferred power to Georgia Power immediately after receiving power from Florida Power

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[76]404 U.S. at p. 456.

[77]*Id.* at p. 456.

[78]A "bus" is a connector or group of connectors that serves as a common connection for two or more circuits.

[79]404 U.S. at p. 457.

[80]*Id.*

& Light.[81] The Supreme Court found that power commingled in the bus moved across state lines, and concluded that Florida Power & Light engaged in transmission in interstate commerce. The **[31,978]** Court held that, to establish jurisdiction, the Commission need only show that "some [Florida Power & Light] power goes out of State."[82] The Court further explained that "(i)f any (Florida Power & Light) power has reached Georgia, or (if Florida Power & Light) makes use of any Georgia power * * * FPC jurisdiction will attach * * *."[83]

There is also a line of cases that address, among other things, what constitutes a Commission jurisdictional "sale of electric energy at wholesale"[84] under section 201 of the FPA.[85] These cases all concerned bundled sales. While the issues posed above involve unbundled wheeling, the "resale" cases are helpful to the extent they suggest that local distribution takes place only after power is subdivided. See, e.g., 345 U.S. at 316 ("the facilities supplied 'local

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[81] *Id.* at p. 457 & n.8.

[82] *Id.* at p. 461. (emphasis omitted).

[83] *Id.* at p. 461 n.10. (emphasis added).

[84] See Section 201(d), 16 U.S.C. §824(d) (1988).

[85] *Public Utilities Commission*, supra note 345; *City of Oakland, California v. FERC*, 754 F.2d 1378 (9th Cir. 1985) (*Oakland*). *See also Alexander v. FERC*, 609 F.2d 543 (D.C. Cir. 1979) (*Alexander*).

distribution' only after the current was subdivided for individual consumers.").

4. Natural Gas Act

The Natural Gas Act (NGA) was adopted in 1938. Like the FPA, the NGA contains language limiting the Commission's jurisdiction in situations involving local distribution.[86]

Section 1(b) of the NGA provides:

The provisions of this Act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural.[87]

There is similarity in many respects between the House and Senate Reports on the FPA and the NGA with respect to the jurisdiction given the Commission. For example, all four reports mention Attleboro as placing interstate wholesale transactions beyond the reach of the

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[86]Courts often rely on cases construing the NGA when interpreting the FPA, and vice versa. *E.g., Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981).

[87]15 U.S.C. §717(b) (emphasis added).

States. As indicated in the House Report on the NGA, the States could "regulate sales to consumers even though such sales are in interstate commerce, such sales being considered local in character and in the absence of congressional prohibition subject to State regulation." (See H.R. Rep. No. 709, 75th Cong., 1st Sess. 1). However, the House and Senate Reports on the NGA contain identical language not found in the reports on the FPA:

In view of the importance of section 1(b), which states the scope of the act, it seems advisable to comment on certain provisions appearing therein. It will be noted that this subsection of the bill, after affirmatively stating the matters to which the act is to apply, contains a provision specifying what the act is not to apply to, as follows:

But shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

The quoted words are not actually necessary, as the matters specified therein could not be said fairly to be covered by the language affirmatively stating the jurisdiction of the Commission, but similar language was in previous bills, and, rather than invite the contention, however unfounded, that the elimination of the negative language would broaden the scope of the act, the committee has included it in this bill. That part of the negative declaration stating that the act shall not apply to "the local distribution of natural gas" is surplusage by reason of the fact that distribution is made only to consumers in connection with sales, and since no jurisdiction is given to the Commission to regulate sales to consumers the

Commission would have no authority over **[31,979]** distribution, whether or not local in character. (Emphasis added).[88]

As a result of this language it can be argued that Congress considered distribution (and local distribution) only in the context of bundled retail sales of natural gas. In fact, it appears that all of the court cases affirming the states' right to regulate local distribution of gas have involved bundled retail sales. See Panhandle Eastern Pipe Line Co. v. Michigan Public Service Commission, 341 U.S. 329 (1951) (Panhandle). There the Court, in affirming the State of Michigan's right to regulate an interstate pipeline's proposed bundled retail sales of gas to industrial consumers, noted that the pipeline company proposed to lay pipeline in "the streets and alleys of Detroit" and ignored the local distribution company's request for additional gas to meet the increased needs of the industrial consumers. Id. at 333. While the Court based its holding on a state's authority to regulate direct (retail) sales to an end- user, rather than on the basis of the section 1(b) local distribution provision, it also found that the proposed sales were "primarily of local interest" and "emphasized the need for local regulation." Id. Two years before Panhandle, the Supreme Court issued its decision in FPC v. East Ohio Gas Co., 338 U.S. 465 (1949) (East Ohio). East Ohio Gas Company owned and operated a natural gas business wholly within the State of Ohio. The company sold gas only to Ohio customers but most of the gas was transported to Ohio from other states by interstate pipelines.

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[88]H.R. Rep. No. 709, 75th Cong., 1st Sess. 3 (1937); S. Rep. No. 1162, 75th Cong., 1st Sess. 3 (1937).

These interstate pipelines connected inside Ohio with East Ohio's large high pressure lines. The gas then was transported over 100 miles through East Ohio's system to its local distribution system. East Ohio argued that it was exempt from Commission jurisdiction because all of its facilities were local distribution. The Court disagreed, finding the Commission's jurisdiction extends over the transportation of gas in interstate commerce through high-pressure transmission lines and that distribution did not begin until the point where pressure is reduced and gas enters local mains. The Court stated that: "[w]hat Congress must have meant by 'facilities' for 'local distribution' was equipment for distributing gas among customers within a particular local community, not the high-pressure pipelines transporting the gas to the local mains."[89]

The Commission relied in part on East Ohio's high pressure/low pressure distinction in a recent NGA section 7 certificate case which authorized construction of facilities to bypass the local distribution company.[90] On appeal, the California Commission argued that under section 1(b) it should at least have "jurisdiction over the 'taps, meters and

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[89]338 U.S. at pp. 469-70.

[90]*See Mojave Pipeline Company*, 35 FERC ¶61,199 (1986), *reh'g denied*, 41 FERC ¶61,040 (1987), *reh'g denied*, 42 FERC ¶61,351 (1988); *see also Mojave Pipeline Company*, 66 FERC ¶61,194 (1994), *reh'g pending*.

other tie-in facilities' that link the pipeline to end users."[91] The court disagreed:

> While as a matter of ordinary English 'local distribution' might be understood to encompass any delivery to an end user, that is hardly the only or even more plausible reading. Distribution conjures up receiving a large quantity of some good and parcelling it out among many takers.[92]

After reviewing the report language discussed above, the court also stated:

> Insofar as congressional committees spoke to the matter * * * they appear to have viewed distribution as confined to its parcelling out function and (probably) even more narrowly, to parcelling out accompanied by retail sales.[93]

In Cascade Natural Gas Corporation v. FERC, et al. (Cascade), the court affirmed the Commission's authorizing an interstate pipeline under section 7 of the NGA "to construct a tap and meter facility that would allow it to deliver natural gas directly to two industrial consumers **[31,980]**

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[91] *See Public Utilities Commission of the State of California v. FERC, et al.*, 900 F.2d 269, 273 (D.C. Cir. 1990) (footnote omitted) (*WyCal*).

[92] *Id.* at p. 276.

[93] *Id.* (emphasis in original).

* * *."[94] To reach the interstate pipeline, the industrials constructed a nine-mile pipeline. Together, the facilities bypassed the local distribution company.[95]

The court rejected arguments that section 1(b) deprived the Commission of jurisdiction holding that:

"Local distribution," as Congress viewed the term, involves two components: the retail sale of natural gas and its local delivery, normally through a network of branch lines designed to supply local consumers.[96]

5. Analysis

a. What facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to a purchaser who will then re-sell the energy to an end user?

The case law supports the conclusion that any facilities of a public utility used to deliver electric energy in interstate commerce to a wholesale purchaser, whether such facilities are labeled "transmission," "distribution" or "local

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[94]955 F.2d 1412, 1414 (10th Cir. 1992).

[95]Unlike the situation in WyCal where the pipeline made direct sales to end users, in Cascade the pipeline transported gas purchased from third parties. *See Northwest Pipeline Corporation*, 51 FERC ¶61,289 at p. 61,909 (1990).

[96]Cascade, 955 F.2d at p. 1421.

distribution," are subject to the Commission's jurisdiction under sections 205 and 206.

This conclusion is supported by Public Utilities Commission, supra, in which the Supreme Court, in the section of its opinion addressing the section 201(b) local distribution provision, held that local distribution facilities began "only after the current was subdivided for individual consumers."[97] Wisconsin-Michigan, supra, in which the Seventh Circuit held that there is no local distribution until the wholesaler who re-sells at retail is reached, is to like effect.

This conclusion, which results in a "functional" line being drawn to determine Commission jurisdiction, is not only consistent with the case law under section 201, but is also consistent with our interpretation of the line drawn under newly amended FPA sections 211 and 212. As long as electric energy is being sold to a legitimate wholesale purchaser, we believe the Commission has jurisdiction under sections 201, 205, and 206 of the FPA over the public utility's facilities used to deliver electric energy to that purchaser.

b. What facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier directly to an end user?

In analyzing jurisdiction over unbundled retail wheeling, we believe it is important to distinguish between unbundled wheeling provided by the public utility who

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[97]345 U.S. at p. 316 (footnote omitted).

previously provided bundled retail service to the end user, and unbundled wheeling provided by other public utilities to the end user. For example, a former bundled retail customer may need unbundled wheeling services from its previous public utility generation supplier, as well as unbundled wheeling from one or more intervening public utilities, in order to reach a distant generation supplier. In this scenario, the Commission believes it would have jurisdiction over all of the facilities used for the unbundled wheeling provided by the intervening public utilities.[98] The more difficult issue is whether some portion of the facilities used to transmit energy from the transmitting utility in closest proximity to the end user (the former supplier of the bundled product) is local distribution facilities. We believe that in most, if not all circumstances, some portion will be local distribution facilities.

The case law is replete with statements that the local distribution provision of section 201 must be given effect. However, the Supreme Court in both CL&P and Colton, supra, has stated that whether facilities are used in local distribution is a question of fact to be decided by the Commission as an original matter. Thus, there is no clear case law on a "bright line" between transmission and local distribution. In addition, regardless **[31,981]** of the details of the chain of delivery services necessary to move electric energy from the generator to the end user, in most cases the last public utility in the chain will use facilities that

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[98]The Commission would not have jurisdiction over the rates for the sale of generation by the distant supplier because the transaction would be a retail sale of electric energy.

historically were considered local distribution facilities. Accordingly, unlike the situation involving unbundled wholesale wheeling, for which the case law clearly supports a "functional" test, the Commission believes the case law and practical realities of a changing industry support an analysis of local distribution facilities based on the facilities' functional as well as technical characteristics.

While it would be preferable to draw an absolutely "bright" line (e.g., based on technical characteristics such as voltage), the Commission does not believe this is required by the case law and, importantly, would not be a workable approach in all cases because of the variety of circumstances that may arise and because utilities themselves classify facilities differently (e.g., one utility may classify a 69 kV facility as transmission; another may classify it as distribution).

Therefore, the Commission is adopting several indicators it will evaluate in determining whether particular facilities are transmission or local distribution in the case of vertically integrated transmission and distribution utilities:[99]

•Local distribution facilities are normally in close proximity to retail customers.

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[99]In the case of a distribution-only utility, which is franchised by a State or local government and sells only at retail, all of the circuits (and related wires, transformers, towers, and rights of way) which it owns or operates (regardless of voltage) would be local distribution facilities.

•Local distribution facilities are primarily radial in character.

•Power flows into local distribution systems, it rarely, if ever, flows out.

•When power enters a local distribution system, it is not reconsigned or transported on to some other market.

•Power entering a local distribution system is consumed in a comparatively restricted geographical area.

•Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.

•Local distribution systems will be of reduced voltage.[100]

In summary, for unbundled wholesale wheeling the Commission will apply a functional test. The only definitive question will be whether the entity to whom the power is delivered is a lawful wholesaler. For unbundled retail wheeling the Commission will apply a combination functional-technical test that will take into account technical characteristics of the facilities used for the wheeling. The

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[100]The Commission has analyzed utilities' filings required by the Commission's regulations. These filings are made on FERC Form No. 1. While there is no uniform breakpoint between transmission and distribution, it appears that utilities account for facilities operated at greater than 30 kV as transmission and that distribution facilities are usually less than 40 kV.

Commission concludes that these tests are consistent with the FPA, its legislative history and the case law discussed above.

Robert C. McDiarmid *
Cynthia S. Bogarad
Peter J. Hopkins
Spiegel & McDiarmid
1350 New York Ave., NW
Washington, D.C. 20005
(202) 829-4000

Counsel for Respondent
Transmission Access Study Group

Charles G. Cole *
David B. Raskin
Alice E. Loughran
Steptoe & Johnson LLP
1330 Connecticut Ave., N.W.
Washington, D.C. 20036
(202) 429-6270

Counsel for Respondent
Edison Electric Institute

* COUNSEL OF RECORD

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Nos. 00-568 AND 00-809

In The

Supreme Court of the United States

People of the State of New York and the Public Service Commission of the State of New York, et al.
Petitioners,

v.

Federal Energy Regulatory Commission, et al.,
Respondents.

Enron Power Marketing, Inc.,
Petitioner,

v.

Federal Energy Regulatory Commission, et al.,
Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

JOINT APPENDIX (Vol. 2 of 2)

Louis R. Cohen *
Wilmer, Cutler & Pickering
2445 M Street, N.W.
Washington, D.C. 20037-1420
(202) 663-6000
For Petitioner/Respondent, Enron Power Mkt., Inc.

Lawrence G. Malone *
Public Service Commission
of the State of New York
Three Empire State Plaza
Albany, NY 12223-1350
(518) 474-2510
For Petitioners, People of the State of New York, et al.

Theodore B. Olson *
Solicitor General
Edwin S. Kneedler
Deputy Solicitor General
Austin C. Schlick
Department of Justice
950 Pennsylvania Ave., N.W.
Room 5259
Washington, D.C. 20530-0001
(202) 514-2217
For Respondent, Federal Energy Regulatory Commission

* COUNSEL OF RECORD

BECKER GALLAGHER LEGAL PUBLISHING, INC.
CINCINNATI, OH 800-890-5001

James Bradford Ramsay
General Counsel
Sharla M. Barklind
Associate General Counsel
National Association of
Regulatory Utility Commissioners
1101 Vermont Ave., N.W., Ste. 200
Washington, D.C. 20005
(202) 898-2208

Catherine D. Bedell
General Counsel
Richard Bellak
Associate General Counsel
Florida Public Service
Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850
(850) 413-6092

Alan G. Lance
Attorney General
Donald L. Howell, II
Deputy Attorney General
Idaho Public Utilities
Commission
472 W. Washington Street
P.O. Box 83720
Boise, ID 83720-0074
(208) 334-0312

John J. Farmer, Jr.
Attorney General
State of New Jersey
Helene S. Wallenstein
Sr. Deputy Attorney General
Attorney for New Jersey Board
of Public Utilities
124 Halsey Street, 5th Floor
P.O. Box 45029
Newark, New Jersey 07101
(973) 648-4846

Counsel for Petitioners/Respondents
State Public Service Commissions

William H. Chambliss
General Counsel
C. Meade Browder, Jr.
Attorney
Virginia State Corp. Comm'n
Office of General Counsel
P.O. Box 1197
Richmond, VA 23218
(804) 371-9671

Christine O. Gregoire
Attorney General
William Berggren Collins
Sr. Assistant Attorney General
Robert D. Cedarbaum, Sr. Counsel
(for the Washington Utilities and
Transportation Commission)
P.O. Box 40128
Olympia, WA 98504-0128
(360) 664-1188

Harvey L. Reiter
(for Vermont Dept. of Public Service)
Morrison & Hecker
1150 18th Street, N.W., Ste. 800
Washington, D.C. 20036
(202) 785-9100

Harry Ivey
(for Wyoming Public Service Comm'n)
Attorney General's Office
State of Wyoming
123 Capitol
Cheyenne, WY 82002
(307) 777-7824

Jo Anne Sanford
North Carolina Utilities Comm'n
Robert P. Gruber
Public Staff - North Carolina
Utilities Comm'n
Gisele L. Rankin, Staff Attorney
P.O. Box 29520
Raleigh, NC 27626-0520
(919) 733-2435

(Counsel continued on inside back cover)

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NOTICE

The following documents have been omitted in the printing of this Appendix. These documents may be found in Petitioner Enron Power Marketing, Inc.'s Appendix to its Petition for Writ of Certiorari (00-809) at the following pages:

APPENDIX A:

Judgment of the United States Court of Appeals for the District of Colombia Circuit filed 6/30/00 . . . . . 1a

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APPENDIX C:

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Some may also be found in the Petitioner's People of the State of New York and The Public Service Commission of the State of New York's Appendix to its Petition for Writ of Certiorari (00-568) at the following pages:

APPENDIX A:

Order of United States Court of Appeals for the District of Columbia Circuit filed 8/22/00 . . . . . A-1

APPENDIX B:

Judgment of United States Court of Appeals for the District of Columbia Circuit filed 6/30/00 . . . . . B-1

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PART 35 - FILING OF RATE SCHEDULES
61 FED. REG. 21692-21695

1. The authority citation for part 35 continues to read as follows:

Authority: 16 U.S.C. 791a-825r, 2501-2645; 31 U.S.C. 9701; 42 U.S.C. 7101-7352,

2. Part 35 is amended by revising§35.15, by redesignating §35.28 as §35.29, and by adding new §§35.26, 35.27, and 35.28 to read as follows:

§35.15 Notices of cancellation or termination

(a) *General rule*. When a rate schedule or part thereof required to be on file with the Commission is proposed to be cancelled or is to terminate by its own terms and no new rate schedule or part thereof is to be filed in its place, each party required to file the schedule shall notify the Commission of the proposed cancellation or termination on the form indicated in §131.53 of this chapter at least sixty days but not more then one hundred-twenty days prior to the date such cancellation or termination is proposed to take effect. A copy of such notice to the Commission shall be duly posted. With such notice each filling party shall submit a statement giving the reasons for the proposed cancellation or termination, and a list of the affected purchasers to whom the notice has been mailed. For good cause shown, the Commission may by order provide that the notice of cancellation or termination shall be effective as of a date prior to the date of filing or prior to the date the filing would became effective in accordance with these rules.

(b) *Applicability*. (1) The provisions of paragraph (a) of this section shall apply to all contracts for unbundled transmission service and all power sale contracts:

(i) Executed prior to July 9,1998; or

(ii) If unexecuted, filed with the Commission prior to July 9, 1996.

(2) Any power sales contract executed on or after July 9, 1996 that is to terminate by its own terms shall not be subject to the provisions of paragraph (a) of this section.

(3) *Notice.* Any public utility providing jurisdictional services under a power sales contract that is not subject to the provisions of paragraph (a) of this section shall notify the Commission of the date of the termination of such contract within 30 days after such termination takes place.

§35.26 Recovery of stranded costs by public utilities and transmitting utilities.

(a) *Purpose.* This section establishes the standards that a public utility or transmitting utility must satisfy in order to recover stranded costs.

(b) *Definitions.*

(1) *Wholesale stranded cost* means any legitimate, prudent and verifiable cost incurred by a public utility or a transmitting utility to provide service to:

(i) A wholesale requirements customer that subsequently becomes, in whole or in part, an unbundled wholesale transmission services customer of such public utility or transmitting utility; or

(ii) A retail customer, or a newly created wholesale power sales customer, that subsequently becomes, in whole or in part, an unbundled wholesale transmission services customer of such public utility or transmitting utility.

(2) *Wholesale requirements customer* means a customer for whom a public utility provides by contract any portion of its bundled wholesale power requirements.

(3) *Wholesale transmission services* has the same meaning as provided in section 3(24) of the Federal Power Act (FPA): the transmission of electric energy sold, or to be sold, at wholesale in interstate commerce.

(4) *Wholesale requirements contract* means a contract under which a public utility or transmitting utility provides any portion of a customer's bundled wholesale power requirements.

(5) *Retail stranded costs* means any legitimate, prudent and verifiable cost incurred by a public utility or transmitting utility to provide service to a retail customer that subsequently becomes, in whole or in part, an unbundled retail transmission services customer of that public utility or transmitting utility.

(6) *Retail transmission services* means the transmission of electric energy sold, or to be sold, in interstate commerce directly to a retail customer.

(7) *New wholesale requirements contract* means any *wholesale requirements* contract extended after July 11, 1994, or extended or renegotiated to be effective after July 11, 1994.

(8) *Existing wholesale requirements* contract means any *wholesale requirements* contract executed on or before July 11, 1994.

(c) *Recovery of wholesale stranded costs.*

(1) *General requirement.* A public utility or transmitting utility will be allowed to seek recovery of wholesale stranded costs only as follows:

(i) No public utility or transmitting utility may seek recovery of wholesale stranded costs if such recovery is explicitly prohibited by a contract or settlement agreement, or by any power sales or transmission rate schedule or tariff.

(ii) No public utility or transmitting utility may seek recovery of stranded costs associated with a new wholesale requirements contract if such contract does not contain an exit fee or other explicit stranded cost provision.

(iii) If wholesale stranded costs are associated with a new wholesale requirements contract containing an exit fee or other explicit stranded cost provision, and the seller under the contract is a public utility, the public utility may seek recovery of such costs, in accordance with the contract, through rates for electric energy under sections 205-208 of the FPA. The public utility may not seek recovery of such costs through any transmission rate for FPA section 205 or 211 transmission services.

(iv) If wholesale stranded costs are associated with a new wholesale requirements contract, and the seller under the contract is a transmitting utility but not also a public utility, the transmitting utility may not seek an order from the Commission allowing recovery of such costs.

(v) If wholesale stranded costs are associated with an existing wholesale requirements contract, if the seller under such contract is a public utility, and if the contract does not contain an exit fee or other explicit stranded cost provision, the public utility may seek recovery of stranded costs only as follows:

(A) If either party to the contract seeks a stranded cost amendment pursuant to a section 205 or section 208 filing under the FPA made prior to the expiration of the contract, and the Commission accepts or approves an amendment permitting recovery of stranded costs, the public utility may seek recovery of such costs through FPA section 205-206 rates for electric energy.

(B) If the contract is not amended to permit recovery of stranded costs as described in paragraph (c)(1)(v)(A) of this

section, the public utility may file a proposal, prior to the expiration of the contract, to recover stranded costs through FPA section 205-206 or section 211-212 rates for wholesale transmission services to the customer.

(vi) If wholesale stranded costs ere associated with an existing wholesale requirments contract, if the seller under such contract is a transmitting utility but not also a public utility, and if the contract does not contain an exit fee or other explicit stranded cost provision, the transmitting utility may seek recovery of stranded costs through FPA section 211-212 transmission rates.

(vii) If a retail customer becomes a legitimate wholesale transmission customer of a public utility or transmitting utility, *e.g.*, through municipalization, and costs are stranded as a result of the retail-turned-wholesale customer's access to wholesale transmission, the utility may seek recovery of such costs through FPA section 205-206 or section 211-212 rates for wholesale transmission services to that customer.

(2) *Evidentiary demonstration for wholesale stranded cost recovery*. A public utility or transmitting utility seeking to recover wholesale stranded costs in accordance with paragraphs (c)(1)(v)-(vii) of this section must demonstrate that:

(i) It incurred stranded costs on behalf of its wholesale requirements customer or retail customer based on a reasonable expectation that the utility would continue to serve the customer;

(ii) The stranded costs are not more than the customer would have contributed to the utility had the customer remained a wholesale requirements customer of the utility, or, in the case of a retail-turned-wholesale customer, had the customer remained a retail customer of utility; and

(iii) The stranded costs are derived using the following formula: Stranded Cost Obligation -- (Revenue Stream Estimate- Competitive Market Value Estimate) x Length of Obligation (reasonable expectation period),

(3) *Rebuttable presumption.* If a public utility or transmitting utility seeks recovery of wholesale stranded costs associated with an existing wholesale requirements contract, as permitted in paragraph (c)(1) of this section, and the existing wholesale requirements contract contains a notice provision, there will be a rebuttable presumption that the utility had no reasonable expectation of continuing to serve the customer beyond the term of the notice provision.

(4) *Procedure for customer to obtain stranded cost estimate.* A customer under an existing wholesale requirements contract with a public utility seller may obtain from the seller an estimate of the customer's stranded cost obligation if it were to leave the public utility's generation supply system by filing with the public utility a request for an estimate at any time prior to the termination date specified in its contract.

(i) The public utility must provide a response within 30 days of receiving the request. The response must include:

(A) An estimate of the customer's stranded cost obligation based on the formula in paragraph (c)(2)(iii) of this section;

(B) Supporting detail indicating how each element in the formula was derived;

(C) A detailed rationale justifying the basis for the utility's reasonable expectation of continuing to serve the customer beyond the termination date in the contract;

(D) An estimate of the amount of released capacity and associated energy that would result from the customer's departure; and

(E) The utility's proposal for any contract amendment needed to implement the customer's payment of stranded costs.

(ii) If tim customer disagrees with the utility's response, it must respond to the utility within 30 days explaining why it disagrees. If the parties cannot work out a mutually agreeable resolution, they may exercise their rights to Commission resolution under the FPA.

(5) A customer must be given the option to market or broker a portion or all of the capacity and energy associated with any stranded costs claimed by the public utility.

(i) To exercise the option, the customer must so notify the utility in writing no later than 30 days after the public utility files its estimate of stranded costs for the customer with the Commission.

(A) Before marketing or brokering can begin, the utility and customer must execute an agreement identifying, at a minimum, the amount and the price of capacity and associated energy the customer is entitled to schedule, and the duration of the customer's marketing or brokering of such capacity and energy.

(ii) If agreement over marketing or brokering cannot be reached, and the parties see Commission resolution of disputed issues, upon issuance of a Commission order resolving the disputed issues, the customer may reevaluate its decision in paragraph (c)(5)(i) of this section to exercise the marketing or brokering option. The customer must notify the utility in writing within 30 days of issuance of the Commission's order resolving the disputed issued whether the customer will market or broker a portion or all of the capacity and energy associated with stranded costs allowed by the Commission.

(iii) If a customer undertakes the brokering option, and the customer's brokering efforts fail to produce a buyer within 60 days of the date of the brokering agreement entered into between the customer and the utility, the customer shall relinquish all rights to broker the released capacity and associated energy and will pay stranded costs as determined by the formula in paragraph (c)(2)(iii) of this section.

(d) *Recovery of retail stranded costs.*

(1) *General requirement.* A public utility may seek to recover retail stranded costs through rates for retail transmission services only if the state regulatory authority does not have authority under state law to address stranded costs at the time the retail wheeling is required.

(2) *Evidentiary demonstration necessary for retail stranded cost recovery.* A public utility seeking to recover retail stranded costs in accordance with paragraph (d)(1) of this section must demonstrate that:

(i) It incurred stranded costs on behalf of a retail customer that obtains retail wheeling based on a reasonable expectation that the utility would continue to serve the customer; and

(ii) The stranded costs are not more than the customer would have contributed to the utility had the customer remained a retail customer of the utility.

§35.27 Power sales at market-based rates.

(a) Notwithstanding any other requirements, any public utility seeking authorization to engage in sales for resale of electric energy at market-based rates shall not be required to demonstrate any lack of market power in generation with respect to sales from capacity for which construction has commenced on or after July 9, 1996.

(b) Nothing in this part

(1) Shall be construed as preempting or affecting any jurisdiction a state commission or other state authority may have under applicable state and federal law, or

(2) Limits the authority of a state commission in accordance with state and federal law to establish

(i) Competitive procedures for the acquisition of electric energy, including demand-side management, purchased at wholesale, or

(ii) Non-discriminatory fees for the distribution of such electric energy to retail consumers for purposes established in accordance with state law.

§35.28 Non-discriminatory open access transmission tariff.

(a) *Applicability*. This section applies to any public utility that owns, controls or operates facilities used for the transmission of electric energy in interstate commerce and to any nonpublic utility that seeks voluntary compliance with jurisdictional transmission tariff reciprocity conditions.

(b) *Definitions*.

(1) *Requirements service agreement* means a contract or rate schedule under which a public utility provides any portion of a customer's bundled wholesale power requirements.

(2) *Economy energy coordination agreement* means a contract, or service schedule thereunder, that provides for trading of electric energy on an "if, as require either the seller or the buyer to engage in a particular transaction.

(3) *Non-economy energy coordination agreement* means any non-requirements service agreement, except an economy energy coordination agreement as defined in paragraph (b)(2) of this section.

(c) *Non-discriminatory open access transmission tariffs.*

(1) Every public utility that owns, controls or operates facilities used for the transmission of electric energy in interstate commerce must have on file with the Commission a tariff applicability for transmission services, including ancillary services, over such facilities. Such tariff must be the open access pro forma tariff contained in Order No. 888. FERC Stats. & Regs. ¶31,036 (Final Rule on Open Access and Stranded Costs) or such other open access tariff as may be approved by the Commission consistant with Order No. 888, FERC Stats. & Regs. ¶31,036.

(i) Subject to the exceptions in paragraphs (c)(1)(ii), (c)(1)(iii), and (c)(1)(iv) of this section, the pro forma tariff contained in Order No. 888, FERC Stats. & Regs. ¶31,036, and accompanying rates, must be filed no later than 60 days prior to the data on which a public utility would engage in a sale of electric energy at wholesale in interstate commerce or in the transmission of electric energy in interstate commerce.

(ii) If a public utility owns, controls or operates facilities used for the transmission of electric energy in interstate commerce as of July 9, 1996, it must file the pro forma tariff contained in Order No. 888, FERC Stats. & Regs. ¶31,036, pursuant to section 206 of the FPA and accompanying rates pursuant to section 205 of the FPA, no later than July 9, 1996. However, if a public utility has already filed, or has on file, an open access tariff and accompanying rates as of April 24, 1996, it may, but is not required to, file new rates with its section 206 pro forma tariff filing.

(iii) If a public utility owns, controls or operates transmission facilities used for the transmission of electric energy in interstate commerce as of July 9, 1996, such

facilities are jointly owned with a non-public utility, and the joint ownership contract prohibits transmission service over the facilities to third parties, the public utility with respect to access over the public utility's share of the jointly owned facilities must file no later than December 31, 1996 the pro forma tariff contained in Order No. 888, FERC Stats. & Regs. ¶31,036, pursuant to section 206 of the FPA and accompanying rates pursuant to section 205 of the FPA.

(iv) If a public utility obtains a waiver of the tariff requirement pursuant to paragraph (d) of this section, it does not need to file the pro forma tariff required by this section.

(v) Any public utility that seeks a deviation from the pro forma tariff combined in Order No. 888, FERC Stats. & Regs. ¶31,036, must demonstrate is consistent with the principles of Order No. 888, FERC Stats. & Regs. ¶31,036.

(2) Every public utility that owns, controls or operates facilities used for the transmission of electric energy in interstate commerce, and tat used those facilities to engage in wholesale sales and/or purchases of electric energy, or unbundled retail sales of electric energy, must take transmission service for such sales and/or purchases under the open access tariff filed pursuant to this section.

(i) Subject to the exceptions in paragraphs (c)(2)(ii) and (c)(3)(iv) of this section, this requirement is effective on the date that such public utility engages in a wholesale sale or purchase of electric energy, but no earlier than July 9, 1996.

(ii) For sales of electric energy pursuant to a requirements service agreement executed on or before July 9, 1996, this requirement will not apply unless separately ordered by the Commission. For sales of electric energy pursuant to a bilateral economy energy coordination agreement executed on or before July 9, 1996, this requirement is effective on December 31, 1996. For sales of

electric energy pursuant to a bilateral non-economy energy coordination agreement executed on or before July 9, 1996, this requirement will not apply unless separately ordered by the Commission.

(2) Every public utility that owns, controls or operates facilities used for the transmission of electric energy in interstate commerce, and that is a member of a power pool, public utility holding company, or other multi-lateral trading arrangement or agreement that contains transmission rates, terms or conditions, must file a joint pool-wide or system-wide open access transmission pro forma tariff.

(i) For any power pool, public utility holding company, or other multi-lateral trading arrangement or agreement that contains transmission rates, terms or conditions and that is executed after July 9, 1996, this requirement is effective on the date that transactions begin under the arrangement or agreement.

(ii) For any public utility holding company arrangement or agreement that contains transmission rates, terms or conditions and that is executed on or before July 9, 1996, this requirement is effective July 9, 1996, except for the Central and South West System, which must comply no later than December 31, 1996.

(iii) For any power pool or multilateral arrangement or agreement other than a public utility holding company arrangement or agreement, that contains transmission rates, terms or conditions and that is executed prior to July 9, 1996, this requirement is effective on December 31, 1996.

(iv) A public utility member of a power pool, public utility holding company or other multi-lateral arrangement or agreement that contains transmission rates, terms or conditions and that is executed on or before July 9, 1996 must begin to take service under a joint pool-wide or system-wide

pro forma tariff for wholesale trades among the pool or system members no later than December 31, 1996.

(d) *Waivers*. A public utility subject to the requirements of this seciion and Order No. 889, FERC Stats. & Regs. ¶31,037 (Final Rule on Open Access Same-Time Information System and Standards of Conduct forPublic Utilities) may file a request for waiver of all or part of the requirements of this section, or Part 37 (Open Access Same-Time Information System and Standards of Conduct for Public Utilities), for good cause shown. An application for waiver must be filed either:

(i) No later than July 9, 1996 or

(ii) No later than 60 days prior to the time the public utility would otherwise have to comply with the requirement.

(e) *Non-public utility procedures for tariff reciprocity compliance*.

(1) A non-public utility may submit a transmission tariff and a request for declaratory order that its voluntary transmission tariff meets the requirements of Order No. 888 (Final Rule on Open Access and Stranded Costs).

(i) Any submittal and request for declaratory order submitted by a non-public utility will be provided an NJ (non-jurisdictional) docket designation.

(ii) If the submittal is found to be an accceptable transmission tariff, an applicant in a Federal Power Act (FPA) section 211 case against the non-public utility shall have the burden of proof to show why service under the open access tariff is not sufficient and why a section 211 order should be granted.

(2) A non-public utility may file a request for waiver of all or part of the reciprocity conditions contained in a public utility open access tariff, for good cause shown. An application for waiver may be filed at any time.

PENNSYLVANIA PUBLIC UTILITY COMMISSION'S PETITION FOR REHEARING

[pp. 1-2]

[1]

UNITED STATES OF AMERICA FEDERAL REGULATORY COMMISSION

[May 23, 1996]

Docket Nos. RM95-8-000 and RM94-7-001

Promoting Wholesale Competition	)
Open Access Non-discriminatory	)
Transmission Services by Public	)
Utilities	)
	)
Recovery of Stranded Costs by	)
Public Utilities and Transmitting	)
Utilities	)
	)

PENNSYLVANIA PUBLIC UTILITY COMMISSION
PETITION FOR REHEARING

BEFORE THE FEDERAL ENERGY REGULATORY COMMISSION:

The Pennsylvania Public Utility Commission ("PaPUC") is the state agency responsible for regulating the rates and service for all privately owned distribution companies and utilities providing electric services within the Commonwealth of Pennsylvania. The PaPUC hereby petitions the Federal Energy Regulatory Commission ("Commission"

or "FERC") for rehearing and reconsideration of its Order No. 888 and the related Final Environmental Impact Statement issued in the above-captioned proceeding consistent with 16 U.S.C. §8251. Specifically, the PaPUC is concerned with the following issues:

Open Access Issues

Issue No. 1 The FERC Has Exceeded the Scope of its Statutory Authority by Requiring Generic Unbundling, Open Access, and Comparability Under Order No. 888.

Issue No. 2 The FERC's Curtailment Policy on a Pro-rata Basis Fails to Hold the Native Load Harmless, "to the extent practical," as Required under the Federal Power Act.

[2]

Issue No. 3 The Redefinition of Federal and State Jurisdiction Under the FERC'S Technical/Functional Test and the Seven Indicia of Distribution are contrary to Law and Fact. (See, Order No. 888 Mimeo at pages 401-443, and Appendix G)

* * * * *

[pp. 18-35]

[18]

Issue No. 2 The FERC's Curtailment Policy on a Pro-rata Basis Fails to Hold the Native Load Harmless, "to the extent practical," as Required under the Federal Power Act.

Under Order No. 888, the transmission provider has the discretion to curtail services, whether firm or non-firm, that will substantially relieve a constraint. That curtailment must be made on a non-discriminatory basis, including the transmission provider's own use of the system, and thus by implication service to the native load.Curtailment must be pro-rata. See, Order No. 888 Mimeo page 335.

While many aspects of the curtailment queue set forth in Order No. 888 are logical, this blanket pro-rata curtailment requirement sets up utility native loads for curtailment while regional, wholesale economic transactions continue to take place. While state curtailment priorities in place, there will already have been a curtailment at the regional level affecting the transmission provider's own use of the system. As part of that use must be to serve the native load, those core customers for whom the system was originally built and maintained under the regulatory compact will be impacted. The degree of those impacts will depend upon the extent and duration of the constraint and the time of day, **[19]** season and climatic conditions under which curtailment takes place.

The PaPUC is particularly aware of this problem in light of experience on January 19, 1994, when pro-rata load shedding was initiated by the Pennsylvania-New Jersey-Maryland Interconnection, in part to preserve economic transactions. As a result, core customers in Pennsylvania ranging from neighborhoods to entire municipalities were abruptly left without power during a record cold spell.

Issue No. 3 The Redefinition of Federal and State Jurisdiction Under the FERC's Technical/Functional Test and the Seven Indicia of Distribution are Contrary to Law and Fact. (See, Order No. 888 Mimeo at pages 401-443, and Appendix G)

Summary

While this issue is presented in the order in which it appears in Order No. 888, it is actually the priority issue for the PaPUC. While specific page cites to the Mimeo Order No. 888 will be provided, the PaPUC also offers a summary of this core issue taken from its Comments and Reply Comments to the MegaNOPR.

> At Order No. 888 Mimeo page 432, the FERC asserts that:
>
> The Commission's assertion of jurisdiction is that if retail transmission in interstate commerce by a public utility occurs voluntarily or as a result of a state retail wheeling program, the Commission has exclusive jurisdiction over the rates, terms and conditions of such transmission and public utilities offering such transmission must comply with the FPA by filing proposed rate schedules under section 205.

Order No. 888, Mimeo at page 432.

The PaPUC is very concerned with respect to the possibility of a "chilling,, of the development of retail

competition given the **[20]** litigation that may attend the FERC's expansive view of jurisdiction over what it terms, "retail transmission,"[18] and "local distribution." The FERC's declaration of jurisdiction over the rates, terms and conditions of retail wheeling service once that service has been ordered or allowed by a state commission creates a powerful disincentive to authorize or to allow retail wheeling. That is inimical to the evolution of a competitive electric industry and threatens to precipitate extensive litigation with respect to jurisdiction.

The FERC's jurisdiction is much more limited than described in Order No. 888. It extends only to wholesale power transmission and transactions. The FERC does not have the authority to order retail wheeling. Further, the PaPUC does not accede to the jurisdictional formula for determining, "interstate transmission," propounded in the NOPR. That formula may be challenged both on engineering and legal grounds.

The PaPUC does not agree, as a matter of law, that the FERC has jurisdiction over what it terms, the rates, terms and conditions of service of unbundled interstate retail transmission service. The PaPUC disagrees with the FERC's

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[18]Retail transmission services, as defined by the FERC, means the transmission of electric energy sold, or to be sold, in interstate commerce directly to a retail customer. NOPR Mimeo, page 310. PaPUC maintains that unless a state has authorized retail wheeling, there can be no sale of electricity in interstate commerce to a retail customer. Even if retail wheeling is authorized the sale of electricity will, most likely, be a function of intrastate commerce.

claim that the "plain meaning," of the Federal Power Act supports this contention. Just **[21]** because there is nothing in the statute, the legislative history, or the case law to indicate that the FERC's jurisdiction over the rates, terms and conditions of transmission in interstate commerce extends only to wholesale transmission and not to retail transmission, that does not amount to a grant of jurisdiction over what are retail services.

With the exception of a change in customer status caused by municipalization, PaPUC challenges both the FERC's attempt to take jurisdiction over retail wheeling and retail stranded costs cases as well as the concept of, "transmission at retail in interstate commerce," or "retail transmission." If a state has not approved wheeling to retail customers, then there is no legal basis for the transaction even to take place.

With respect to the FERC's analysis of jurisdictional facilities and line-drawing between transmission and distribution plant, the PaPUC agrees that the Federal Power Act and case law supports the conclusion that facilities of a public utility used to deliver electric energy in interstate commerce to a wholesale purchaser are subject to the FERC's jurisdiction. Whether such facilities are labeled "transmission," "distribution" or ,local distribution," makes a great deal of difference, however, as the United States Supreme Court made clear in the key case of Connecticut Light & Power Company v. Federal Power Commission,[19] In that case, the United States Supreme Court interpreted the

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[19]Id.

Federal Power Act's Section 201(b) local distribution provision, **[22]** effectively dismissing the very sort of, "negative authority," and combined technical-functional arguments for federal jurisdiction made by the FERC throughout the MegaNOPR and Order No. 888.

The FERC proposes technical factors to evaluate whether particular facilities are transmission or local distribution facilities in the case of vertically integrated transmission and distribution utilities. Those seven indicia of distribution are neither accurate nor acceptable measures of local distribution.

The FERC contends at page 282 of the MegaNOPR and page 403 of the order No. 888 Mimeo that there are seven indicia of local distribution. While advancing the offer of deference to state determinations of what constitutes distribution, the FERC requires the application of the seven indicia by the states in making those determinations. See, Order No. 888 Mimeo at page 430. PaPUC will list those indicia and explain why they are not acceptable measures of local distribution:

1. Local distribution facilities are normally in close proximity to retail customers.

The definition of, "in close proximity," is manifestly unclear and a fertile ground for litigation. By this indicia, the very retail customers that take service at high voltage from transmission lines might be viewed as rendering those lines local distribution facilities by virtue of their close proximity to a retail customer.

[23]

2. Local distribution facilities are primarily radial in character.

Electric distribution may be "radial in character," because the physics of the system as originally constructed dictated that arrangement. But distribution is not always radial in character, nor do the physics of the system require that the system be radial in character. There is no jurisdictional magic in the radial character of distribution lines. Distribution circuits are often networked or looped with adjacent distribution circuits for reliability and load shifting purposes. On the other hand, distribution lines in rural areas are often radial because the circuits are not in close enough proximity to be looped or networked. In short, the radial character of a distribution system (or the lack of same) is not an indicia of local distribution.

3. Power flows into local distribution systems, it rarely, if ever, flows out.

Again, this is a rather gross oversimplification of an engineering concept. All electric power flows out from generators and into the transmission and distribution systems. This concept is dispositive of nothing, including jurisdictional arguments. Whatever power load a circuit cannot absorb goes elsewhere, i.e. it, "flows out."

[24]

4. When power enters a local distribution system, it is not reconsigned or transported on to some other market.

Nor is power reconsigned or transported on to some other market on the transmission grid. This indicia points up the FERC's fundamental failure to understand the dramatically different physics of the electric transmission system. Unlike gas pipelines, which can be packed with molecules that are directed along a closed system, energy transmission is a function of generator location and power displacement. Electric energy is not consigned or transported. Generation and transmission assets are used to increase capacity in a particular area to accommodate coordinated generation and transmission from other areas. Unlike natural gas, there is simply no way to, "paint" an electron a particular color, and to track it from the west to its ultimate destination in the east. Electrons do not move in that fashion. The FERC is confusing consignment and transportation with energizing the grid.

5. Power entering a local distribution system is consumed in a comparatively restricted geographical area.

Again, this indicia is not dispositive of the jurisdictional question. All power is consumed in restricted geographical areas. The electrons leaving a generation plant in Ohio are not the same electrons that arrive in New York.

[25]

6. Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.

Meters can be, and often are, installed at many points within the power grid as part of a utility's telemetry system

for monitoring the performance of its system. This indicia does not resolve jurisdictional issues but merely reflects a physical manifestation of economic and reliability requirements.

7. Local distribution systems will be of reduced voltage.

In footnote 396 which refers to this indicia, the FERC states:

> The Commission has analyzed utilities' filings required by the Commission's regulations. These filings are made on FERC Form No. 1. While there is no uniform breakpoint between transmission and distribution, it appears that utilities account for facilities operated at greater than 30 kV as transmission and that distribution facilities are usually less than 40 kV.

This generalization is not helpful in resolving the jurisdictional issue, because local distribution can and does occur at levels both higher and lower than those provided by the FERC. Distribution to light industry can occur at 69 kY. Advances in the state of the art now allow a retail residential single phase customer to be served directly from a 34 kV line. Twenty-five years ago, this customer would typically have been served from a 4.16 kV distribution circuit. Does the FERC propose to continue to re-draw its jurisdictional line, periodically, based on technological advances?

Note that regardless of what line of case-law the parties follow, whether AGD or CL&P, the FERC itself states in Order No. **[26]** 888 that, ". . . the cases simply do not resolve dispositively these jurisdictional issues when they arise in the context of the market structures and unbundled transactions being contemplated in today's electric industry." Order No. 888 Mimeo at page 429.

Nothing set forth in Order No. 888, save an as yet undefined offer of deference to state authorities which will be discussed below, changes the positions of the FERC or the PaPUC which have been consistent from July, 1994, when the FERC first articulated its new jurisdictional theories in the original Stranded Cost NOPR.[20]

The PaPUC offers its further assessment of the FERC's jurisdictional theory as articulated in Order No. 888. Eligibility to receive unbundled transmission service is not limited to wholesale customers under Order No. 888. The FERC contends: "It is irrelevant to the Commission's jurisdiction whether the customer receiving the unbundled transmission service in interstate commerce is a wholesale or retail customer." See, Order No. 888 Mimeo page 157. Given the fundamental disagreement with the FERC's jurisdictional theories as finalized in Order No. 888, this contention cannot be allowed to stand. To the PaPUC, it is quite relevant whether a customer is receiving wholesale or retail service. Redefining transmission and distribution service as the FERC

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[20] F.E.R.C. Docket No. RM94-7-000, Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, 67 F.E.R.C. ¶61,394 (1994).

does in Order No. 888 does not automatically convey jurisdiction to the FERC, particularly as that redefinition is **[27]** based on an approach specifically rejected by the United States Supreme Court in Connecticut Light & Power Company v. Federal Power Commission.[21]

The PaPUC disagrees as a matter of law with the FERC's assertion that the FERC has exclusive jurisdiction over what it has defined as, "retail transmission." See, Order No. 888 Mimeo page 401. The FERC is impermissibly attempting to expand its jurisdiction, not by virtue of new statutory authority, but by an impermissibly broad and technically insupportable re-definition of existing statutory authority. If it was the intent of Congress to do something so substantial as to redefine and to restructure the electric industry as is argued by the FERC, that intent would be explicit and would not have to be interpreted. In this respect, witness the hearings held before both the U.S. House Energy and Power Subcommittee and the U.S. Senate Energy and Natural Resources Committee thus far on 1996. Those hearings have repeatedly raised the question, both expressly and impliedly, as to whether the FERC has the requisite statutory authority to restructure the electric industry. If the Congress, which the FERC consistently points to as having mandated industry restructuring, must ask such questions then it is questionable whether the FERC's interpretation of the scope of the Energy Policy Act Amendments and the will of Congress is correct.

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[21]324 U.S. 515, 65 S.Ct. 749, 89 L.Ed. 1150 (1945).

The PaPUC questions the seven indicia of distribution proposed by the FERC on the basis of both fact and law as stated, above. **[28]** See, Order No. 888 Mimeo page 403.

The PaPUC questions as a matter of law the FERC's definition of the, "traditional tasks of state and federal regulators." See, Order No. 888 Mimeo pages 428-429, See also, fn 541 at p. 431, fn. 544 at p. 435. At the heart of this issue is a fundamental difference with respect to the interpretation of Section 201(b) of the Federal Power Act, the Supremacy Clause, and the X Amendment of the United States Constitution.

FERC Deference to the States

The PaPUC requests clarification of the concept of deference to the states in the definition of local distribution services as first articulated in Order No. 888. The FERC announces this deference at several points in the order, but the FERC does not clarify what a state regulatory agency must demonstrate to secure deference. Further, the FERC offers utilities the opportunity to initiate jurisdictional determinations, by the FERC, regardless of what a state might do. It is only required that a utility first, "consult," with a state prior to coming to the FERC for a jurisdictional determination, and the nature of that, "consultation," is undefined. The language of Order No. 888 also poses a problem for those states contemplating retail wheeling in that deference requires the application of the seven indicia of distribution and conclusions consistent with the findings of Order No. 888:

[29]

> Determining where to draw the jurisdictional line for facilities used in unbundled retail wheeling transactions will involve case-specific determinations that evaluate the seven local distribution indicators that we are adopting. We believe that the Commission should take advantage of state regulatory authorities' knowledge and expertise concerning the facilities of the utilities that they regulate. Therefore, in instances of unbundled retail wheeling that occurs as a result of a state retail access program, we will defer to recommendations by state regulatory authorities concerning where to draw the jurisdictional line under the Commission's technical test for local distribution facilities, and how to allocate costs for such facilities to be included in rates, provided that such recommendations are consistent with the essential elements of the Final Rule.[[548] Footnote in Order No. 888] Moreover, we recognize that in some cases the Commission's seven technical factors may not be fully dispositive and that states may find other technical factors that may be relevant. We will consider jurisdictional recommendations by

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[548]In order to give such deference, we expect state regulators to specifically evaluate the seven indicators and any other relevant facts and to make recommendations consistent with the essential elements of the Rule.

> states that take into account other technical factors that the state believes are appropriate in light of historical uses of particular facilities.

Order 888 Mimeo at pages 438-439.

This deference provision appears, on its face, only to grant deference in those cases where a state implements the FERC's seven indicia of local distribution and the balance of the open access and comparability portions of the order as stated. Of greater importance to the states are the final two sentences of the quote, above:

[30]

> Moreover, we recognize that in some cases the Commission's seven technical factors may not be fully dispositive and that states may find other technical factors that may be relevant. We will consider jurisdictional recommendations by states that take into account other technical factors that the state believes are appropriate in light of historical uses of particular facilities.

Order No. 888 Mimeo at page 439.

Note well that variations from the seven indicia of distribution are not deferred to; they are subject to the FERC's consideration. This is a critical distinction that requires elaboration by the FERC.

Given the crucial difference between, "deference" and "consideration," it is clear that under Order No. 888 any state

that authorizes or allows retail wheeling faces the risk of attempted federal preemption by the FERC. The extent of that risk, and the efficacy of the undefined vehicle for FERC, "consideration" of state jurisdictional recommendations beyond the seven indicia of distribution remain unknown.

FERC Resolution of Jurisdictional Issues Initiated by Utilities

Equally troubling is what might be construed as the FERC's attempt to set itself up as a de facto appellate authority should a utility, "consult" with its state regulator but then go to the FERC for a jurisdictional determination. Carefully consider the following language from Order No. 888:

[31]

> Some commenters have asked the Commission to provide a forum to prevent or resolve disputes over the correct classification of facilities as transmission or local distribution. As a means of facilitating jurisdictional line-drawing, we will entertain proposals by public utilities, filed under section 205 of the FPA, containing classifications and/or cost allocations for transmission and local distribution facilities. However, as a prerequisite to filing transmission/local distribution facility classifications and/or cost allocations with the Commission, utilities must consult with their state regulatory authorities. If the utility's classifications and/or cost allocations are supported by the state regulatory authorities and are consistent with

> the principles established in the Final Rule, the Commission will defer to such classifications and/or cost allocations. [footnote deleted] We encourage public utilities and their state regulatory authorities to attempt to agree to utility-specific classifications and allocations that the utility may file at the Commission.

Order No. 888 Mimeo at 439-440 (emphasis added)

This section of Order No. 888 appears to leave the door open to utilities to circumvent the statutory authority of state regulators. It is not clear what the FERC will do if a utility's classifications and/or cost allocations are <u>not</u> supported by state regulatory authorities. This must be clarified.

<u>FERC Assertion of Jurisdiction Over the Rates, Terms and Conditions of, "Unbundled Retail Transmission."</u>

In its Comments and Reply Comments to the MegaNOPR, the PaPUC challenged the FERC's assertion of jurisdiction over what it terms, "retail transmission." The FERC has reiterated that jurisdictional claim in Order No. 888. In this area, the FERC also speaks of, "deference" to state regulators:

[32]

> A number of commenters have asked the Commission to defer to state commission recommendations or decisions regarding rates, terms and conditions of unbundled retail transmission in interstate commerce by public utilities. Some have suggested that we set

> broad guidelines for such rates, terms, and conditions, and then allow states to actually implement the guidelines. While the Commission cannot simply turn over its jurisdiction for the states to implement, we understand the concerns raised by many state regulators and believe that deference to state commissions with regard to rates, terms, and conditions may be appropriate in some circumstances, as discussed below.
>
> As we determined in the NOPR, when unbundled retail wheeling in interstate commerce occurs, the transaction has two components for jurisdictional purposes - - a transmission component and a local distribution component. The Commission has jurisdiction over facilities used for the local distribution component. [[550] Footnote in Order No. 888] Thus, the rates, terms and conditions of unbundled retail transmission by a public utility must be filed at the Commission. When this occurs, we will generally expect unbundled retail wheeling customers to take service under the same FERC tariff that applies to wholesale customers. However, if the unbundled retail wheeling occurs as part of

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[550] As discussed above, even if there were instances where no local distribution facilities are used, we believe states have authority over the service of delivering electric energy to end users.

> a state retail access program, it may be appropriate to have a separate retail transmission tariff [[551] Footnote in Order No. 888] to accommodate the design and special needs of such programs. In such situations, the Commission will defer to state requests for variations from the FERC wholesale tariff to meet these local concerns, so long as the separate retail tariff is consistent with the Commission's open access policies and comparability principles reflected in the tariff prescribed by this Final Rule. In addition, rates must be consistent with our Transmission Pricing Policy Statement, and the guidance herein concerning ancillary **[33]** services. [[552] Footnote in Order No. 888]

Order No. 888 Mimeo at pages 440-441 (emphasis added)

The extent of, "deference" under this statement is undefined and is, perhaps, unknowable outside of specific proceedings. The PaPUC does not accept the FERC's claim of jurisdiction over, "retail transmission," and consequently must challenge the FERC's pronouncement of jurisdiction over the rates, terms and conditions of such service.

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[551] I.e., the tariff would be different from the tariff that applies to wholesale customers. Such tariff would still be filed with the Commission under FPA section 205.

[552] In applying the principles of the Final Rule to retail transmission tariffs, the Commission clearly cannot order retail wheeling directly to an ultimate consumer. See FPA section 212(h).

Buy-sell Transactions

In the MegaNOPR, the FERC discussed buy-sell transactions as a potential threat to FERC jurisdiction. That discussion is reiterated in Order No. 888:

> A final jurisdictional issue raised in the Open Access NOPR concerns buy-sell transactions. We remain concerned, just as we were with buy-sell arrangements in the gas industry, that buy-sell arrangements can be used by parties to obfuscate the true transactions taking place and thereby allow parties to circumvent Commission regulation of transmission in interstate commerce. Thus, we reaffim our conclusion that we have jurisdiction over the interstate transmission component of transactions in which an end user arranges for the purchase of generation from a third-party. However, we recognize that there is a wide range of programs and transactions that might or might not fall within this category. We will address these on a case-by-case basis.

Order No. 888 at page 442

[34]
Again, there is a potential for a jurisdictional conflict with respect to buy-sell transactions to end users that are retail end users. This is a direct consequence of the FERC's "technical-functional test" for jurisdiction. That test is challenged by the PaPUC on legal and technical grounds as described, above.

Conclusion and Summary of the Jurisdictional Section of Order No. 888

The PaPUC renews its objection to the jurisdictional theories of the FERC as summarized at pages 442-443 of Order No. 888:

> In summary, the Commission reaffirms and clarifies its prior jurisdictional conclusions and tests for determining the demarcation between federal and state jurisdiction over transmission in interstate commerce and local distribution. We have attempted to address these issues in a way that provides for flexibility and recognition of legitimate state concerns. With regard to retail services, we recognize the states' concerns that the unbundling of retail transactions would result in changes from what historically has been regulated by the states (principally, the rates of transmission assets previously included in retail rate base). However, the decision to provide unbundled retail wheeling is not the Commission's to make because we have no authority to order transmission directly to an ultimate consumer. In addition, even if a retail access program occurs, we do not believe the unbundling of retail transactions will radically change fundamental state authorities, including authority to regulate the vast majority of generation asset costs, the siting and maintenance of generation facilities and transmission lines, and decisions regarding

> retail service territories. Further, the Commission intends to be respectful of state objectives so long as they do not balkanize interstate transmission of power or conflict with our interstate open access policies. As the electric industry and state regulatory authorities continue to develop new competitive market structures and consider retail wheeling programs, we believe that the tests and mechanisms we have provided in this Rule will accommodate both Federal and state interests and will help provide jurisdictional certainty to market participants.

[35]
Order No. 888 Mimeo at pages 442-443 (emphasis added)

The PaPUC views with concern the tacit admission by the FERC that assets previously included in retail rate base will be effectively removed from that rate base by virtue of the FERC's re-definition of, "transmission." As those assets were, most likely, previously reviewed and approved by state regulators and form an intrinsic part of state-jurisdictional utility rate base, it is unacceptable for the FERC unilaterally to attempt to wrest jurisdiction from the states. Whether or not one agrees with the regulatory compact and traditional rate-making, the fact remains that the transmission assets previously included (and still included) in retail ratebase are in that rate base as a result of statute. FERC can point to no law that allows it to take jurisdiction of these assets. The inherent and historic nature and use of these facilities by state jurisdictional utilities and their core retail customers virtually

compels state defense of its jurisdiction lest the core of that jurisdiction be undermined.

REQUEST OF THE STAFF OF THE VIRGINIA STATE CORPORATION COMMISSION FOR REHEARING

[p. 1]

United States of America
Federal Energy Regulatory Commission

Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities	)
Recovery of Stranded Costs by Public Utilities and Transmitting Utilities	)

Docket Nos. RM95-8-001 and RM94-7-002

REQUEST OF THE STAFF OF THE VIRGINIA STATE CORPORATION COMMISSION FOR REHEARING

The Staff of the Virginia State Corporation Commission ("VSCC Staff"), pursuant to Rule 713 of the commission's Rules of Practice and Procedure, 18 C.F.R. 385.713, hereby requests rehearing of the Commission's Order No. 888 issued in the above-captioned proceeding on April 24, 1996. Order 888 is unlawful or improper for the following reasons:

1. FERC exceeded the scope of its statutory authority by requiring generic industry-wide unbundling, open access, and comparability.

2. FERC's finding of industry-wide undue discrimination is not supported by the record.

3. FERC's assertion of jurisdiction over the rates, terms and conditions of unbundled retail transmission services is contrary to law.

4. FERC's assertion of jurisdiction over stranded costs related to retail wheeling is contrary to law.

5. FERC's assertion of jurisdiction over stranded costs from retail-turned-wholesale customers is contrary to law.

* * * * *

[pp. 3-9]

[3]

3. FERC's assertion of jurisdiction over the rates, terms and conditions of unbundled retail transmission services is contrary to law.

In Order 888, FERC asserts that "it has exclusive jurisdiction over unbundled retail transmission in interstate commerce by public utilities." FERC also asserts that "it is irrelevant to the Commission's jurisdiction whether the customer receiving the unbundled transmission service in interstate commerce is a wholesale or retail customer." However, FERC cannot point to any specific legal authorization for such jurisdiction, and in fact admits that the law is not clear on this issue. This ambiguity should not be resolved in favor of expanding FERC's jurisdiction.

VSCC Staff agrees with FERC that the law is not dispositive on the question of unbundled retail transmission services. Section 201(a) of the FPA gives FERC **[4]** jurisdiction over ". . . the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce." Cases interpreting the FPA have not addressed the question of whether FERC's jurisdiction over transmission extends to retail customers.[1] However, one court expressly applied the wholesale versus retail distinction to distinguish transmission and local distribution.[2] FERC should apply the wholesale versus retail analysis to the question of unbundled retail transmission.

The legislative history of the FPA does not resolve this jurisdictional question and it provides little support for FERC's conclusion that the act of unbundling generation from delivery shifts jurisdiction from a state to FERC. If anything, the jurisdictional structure of the FPA is predicated on the distinction between retail and wholesale transactions, not bundled and unbundled services. When Congress enacted the Energy Policy Act of 1992 (EPAct"), it reaffirmed the wholesale/retail distinction. It amended Section 212 of the FPA to prohibit FERC from issuing orders that require transmission of electric energy to a retail consumer, or that are otherwise inconsistent with state-regulated retail marketing

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[1]Jersey Central Power & Light Co. V. FPC, 319 U.S. 61 (1943); FPC v. Southern California Edison Co., 3876 U.S. 205 (1964); Arkansas Electric Cooperative Corp. V. Arkansas Public Service Commission, 461 U.S. 375 (1983).

[2]Wisconsin-Michigan Power Co. V. FPC, 197 F.2d 472 (7th Cir. 1952), cert. denied, 345 U.S. 934 (1953).

areas of electric utilities. Further, Section 212(h) of the EPAct includes a provision protecting state authority "concerning the transmission of electric energy directly to an ultimate consumer" from interference by FERC's newly-expanded authority to order wholesale transmission services.

FERC should conclude that the rates, terms and conditions of service for delivery of power by a utility to an end-use customer are subject to state jurisdiction, regardless of **[5]** the identity of the party generating or reselling the power or the facilities used to transport the power. This clarification of jurisdiction over delivery of third-party power to an end-user would promote FERC's competitive goals, and it would facilitate state retail wheeling programs that would have otherwise been hindered by Order 888's jurisdictional uncertainty.

4. FERC's assertion of jurisdiction over stranded costs related to retail wheeling is contrary to law.

A state, not FERC, has exclusive jurisdiction over any costs incurred on behalf of a retail customer. In Order 888, FERC asserts that a retail customer who leaves its native utility and takes retail service from an alternative supplier has crossed into the threshold of FERC jurisdiction. This has no basis in law, given the clear restriction on FERC's jurisdiction set forth in the FPA. Section 201(b)(1) restricts FERC's jurisdiction to wholesale sales, and explicitly excludes "any other sale of electric energy." A departing retail customer remains a retail customer, regardless of supplier. No portion of the transaction is a wholesale sale, and there are no wholesale costs associated with a retail

wheeling transaction. Therefore, FERC has no valid claim to address stranded costs arising from retail wheeling.

5. FERC's assertion of jurisdiction over stranded costs from retail-turned-wholesale customers is contrary to law.

Like its assertion of jurisdiction over stranded costs related to retail wheeling, FERC asserts that stranded costs arising from retail-turned-wholesale transactions are subject to FERC's jurisdiction. A change in a customer's status from retail to wholesale (e.g. through municipalization) does not change the status of historical costs. Costs **[6]** incurred on behalf of retail customers are subject to state jurisdiction. Whether a retail customer becomes a retail or wholesale customer of another utility is irrelevant for jurisdictional purposes. Any stranded costs associated with either transaction are costs incurred on behalf of a retail customer. The costs cannot be considered wholesale or transmission (thus FERC-jurisdictional) costs. Thus, there is no legal basis for FERC jurisdiction.

6. The reservation and curtailment priorities in the pro forma tariff fail to protect native load customers, who have paid for the existing transmission system.

Order 888 does not adequately protect native load customers. Native load customers have paid a large portion of the costs of the existing transmission system, and they have endured the environmental and aesthetic impacts associated with transmission lines. They depend on the utility, and unreliable service harms them. Native load customers should

be first in line to receive reserved transmission capacity and last in line to be curtailed in the event of a system constraint. The reservation and curtailment priorities established in Order 888 provide inadequate protection to native load. There are ambiguities in the Order that could be resolved in favor of economic transactions, to the detriment of native load.

A. Reservation Priority

Reservation priority establishes the order in which customers can obtain service. Order 888 allows utilities to reserve existing transmission capacity needed for native load growth and network load growth reasonably forecasted within the utility's current planning horizon. Any capacity reserved for future growth that is not currently needed [7] must be posted on the OASIS and made available to others until it is actually needed and used. Further, the Order gives existing firm customers a right of first refusal to existing capacity beyond the terms of their contracts, if they match the rate and contract length offered by another potential customer.

The Order gives native load customers some assurance that they will be entitled to receive service and that sufficient capacity will be reserved for them. However, forecasting load growth and calculating the amount of available transmission capability ("ATC") will be imprecise, at best. Forecasts of transmission load growth are more uncertain than forecasts for generation-related capacity requirements because such forecasts must predict where electrical demands will occur in addition to the magnitude of those loads. Calculations of ATC will be subject to uncertainties associated with load growth, load factors, generating unit availabilities, generating unit additions and retirements, economic

conditions, anomalies in weather, and numerous other factors. Further, in the past, utilities cooperated readily in transmission planning and construction. Under FERC's scheme, they will potentially be competitors and will be less likely to disclose their plans to each other. It will be very difficult, if not impossible, to determine the actual ACT on the transmission grid over both the long and short terms. Further complicating matters is the fact that FERC did not establish any specific method for calculating ATC, and instead will require utilities to file their own methods for calculating ATC.

The possibility that non-native customers could reserve capacity over the economic and reliability needs of native load customers is similar to problems associated **[8]** with the avoided costs provisions of PURPA, where third party power producers were able to enter into long-term purchased power contracts that were based on projections of needed capacity and energy prices. Those projections sometimes resulted in expensive above-market contracts that adversely affected native load customers. Undue reliance on projections has also resulted in uneconomic utility projects. While some reliance on forecasts is a necessity, locking in native load capacity based on imprecise forecasts (and subsequent calculations of ACT) represents a serious and unwarranted risk. Forecasting errors will occur, but native load should not have to bear the burden of these errors.

The Order does not address what will happen if a utility's forecast is too low, and this issue requires clarification. Will native load be entitled to receive sufficient capacity, even though the actual growth exceeded the forecast? Will the calculation of ATC reflect the actual

growth in native load instead of the forecasted growth? Can a utility resell capacity (not reserved for native load because of a low forecast) that is ultimately needed for native load? Is there a fallback mechanism to protect native load customers from a utility's unreasonable forecasts?

Reservation priority must protect native load and give utilities flexibility. The Order should require utilities to reserve sufficient capacity to serve the current and projected needs of native load customers, the wholesale and retail customers on whose behalf the present transmission system was built. The definition of native load customers in Section 1.19 of the tariff should explicitly include existing distribution cooperatives and others who currently provide serve to end users (e.g. · municipally-owned utilities). FERC should establish the following reservation priority: native load customers, **[9]** followed by firm contract customers, and last, non-firm customers. FERC should emphasize that the calculation of ATC must not include any capacity that may be needed by native load customers.

MOTION FOR REHEARING OF THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK

[pp.1-22]

[1]

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

[Filed May 24, 1996]

Docket Nos. RM95-8-001 and RM94-7-002

Promoting Wholesale Competition	)
Through Open Access	)
Non-discriminatory Transmission	)
Services by Public Utilities	)
	)
Recovery of Stranded Costs by	)
Public Utilities and	)
Transmitting Utilities	)
	)

MOTION FOR REHEARING OF THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK

PRELIMINARY STATEMENT

The recent issuance by the Federal Energy Regulatory Commission ("FERC" or "Commission") of Order Nos. 888 and 889 lays the foundation for a new era of competition in the electric industry by opening access to electric transmission

systems nationwide. This week, the Public Service Commission of the State of New York ("PSCNY") built on this foundation by declaring its intention to open the state's seven investor-owned electric utilities and the integrated New York Power Pool to wholesale competition in 1997 and to retail access by all classes of electric customers in 1998.[1] These actions make cooperative federalism a reality by bringing the benefits of competition to electric ratepayers in New York State and across the nation. Competition in the generation and energy service **[2]** businesses will lower rates and increase choice of electric providers and innovative energy services.

Accomplishing the shared goal of promoting open access and competition, however, cannot alter the Jurisdictional boundaries between FERC and the states prescribed by Congress in the Federal Power Act. Effective competition must be accomplished by observing the dual Jurisdictional framework, which prescribes that state agencies retain Jurisdiction of retail services, and encourages cooperation between the relevant state and federal administrations. Although the Commission provided deference to state authority in certain areas, FERC Order 888 intrudes on state Jurisdiction in the areas of stranded retail costs and local distribution of electricity. Accordingly, PSCNY moves

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[1]New York Pub. Serv. Comm'n Case No. 94-E-0952, In the Matter of Competitive Opportunities Regarding Electric Service, Opinion and Order Regarding Competitive Opportunities for Electric Service, Opinion No. 96-12 (issued May 20, 1996).

pursuant to Rule 713 for rehearing of FERC Order 888 as a final agency action.[1]

In Point I, PSCNY requests that FERC declare that it will not backstop state determinations on retail stranded cost recovery. Point II asks FERC to recognize that the states have authority to determine the level of retail-turned-wholesale stranded costs. Point III addresses the fact that, although Order 888 states that FERC will defer to state recommendations on distinguishing transmission from local distribution facilities, the final rules require states to apply the seven factors enunciated in the NOPR, of which PSCNY opposed five in its comments thereon. Hence, [3] PSCNY asks the commission to abandon its seven indicator test for distinguishing transmission from local distribution in favor a straightforward functional standard. Finally, although we appreciate the guidance FERC has provided for formation of independent system operators (ISOs) for power pools, the Commission's ISO principles constrain governance options. Point IV, therefore, asks FERC to clarify that it will defer to state-brokered solutions and provide maximum flexibility for creative solutions to assure open access and effective competition in "tight" (integrated) power pools.

By making this motion for rehearing, we do not seek to delay implementation of FERC's final rules. Rather, the PSCNY looks forward to working closely with FERC in implementing state and federal initiatives promoting electric competition. Accordingly, we ask the FERC to modify Order 888 to expedite implementation.

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[1] 16 U.S.C. §8251(a); 18 C.F.R. §385.713(b).

PROCEDURAL HISTORY

On June 29, 1994, the commission issued its original Notice of Proposed Rulemaking on utility stranded costs incurred during the transition to competition in the electric industry.[1] In that NOPR, the commission declared that it had Jurisdiction over rate recovery of utility investments that were stranded due to retail wheeling, and would act as a backstop to state action on retail stranded costs. The PSCNY filed initial comments on **[4]** December 8, 1994 and reply comments on January 24, 1995.[1] In those comments, we stated that "the notion of FERC generally agreeing to act as a backstop to state action, however, could impede state implementation of restructuring programs or transition policies.[2] We further noted that retail stranded costs are a state regulatory concern.

The Commission issued a notice of proposed rulemaking concerning transmission open access and a supplemental notice of proposed rulemaking on stranded cost

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[1]Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Docket No. RM-94-7-000, 59 Fed. Reg. 35274 (July 11, 1994).

[1]New York State Public Service Comments on the Proposed Rule, Docket No. RM94-7-000 (December 8, 1994); Reply Comments of the New York State Public Service Commission (January 24, 1994).

[2]NYPSC Reply Comments (January 24, 1995), at 2.

recovery on March 29, 1995.[3] Known as the "MegaNOPR", the proposed rulemaking provided, among other things, that: (1) FERC has authority over retail stranded costs and would backstop the states on utility recovery of retail stranded costs, (2) FERC would determine the level, timing and method of recovery of retail-turned-wholesale costs stranded by the creation of new wholesale entities, such as municipal electric utilities, (3) FERC had jurisdiction over transmission facilities, would determine which facilities are transmission and those that were exclusively local **[5]** distribution, and would use a seven-factor test for making that determination.

In our initial comments on the MegaNOPR, the PSCNY argued, among other points, that FERC lacks authority over retail stranded costs, including retail-turned-wholesale costs, and that the NOPR's treatment of local distribution in wholesale power transactions contravenes state authority.[1] In reply comments, we urged FERC to ameliorate the prospect of litigation over retail-turned-wholesale costs by

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[3]Promoting Wholesale Competition Through Open-Access Non-Discriminatory Transmission Service by Public Utilities, Docket No. RM95-8-000, and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Docket No. RM94-7-001, Notice of Proposed Rulemaking and Supplemental Notice of Proposed Rulemaking, 60 Fed. Reg. 17662 (April 7, 1995).

[1]Comments of the Public Service Commission of the State of New York (August 4, 1995).

allowing the states to determine the level of stranded costs to be recovered in transmission rates.[2]

On April 24, 1996, FERC issued its final rules on transmission open access and stranded cost recovery.[3] FERC Order No. S88 should generally assist the transition to a competitive electric marketplace through the filing by utilities of non-discriminatory open access transmission **[6]** tariffs, the transparent provision of information on wholesale power transactions, and the required unbundling of transmission operation functions from wholesale marketing of electricity. FERC properly noted its deference to the states on several matters, including ordering retail wheeling to ultimate customers, service reliability, generation and transmission siting, local distribution of electricity, and authority to impose

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[2]Reply Comments of the Public Service Commission of the State of New York. The PSCNY also made presentations at technical conferences convened by FERC on October 27, 1995 regarding the proposed pro forma transmission tariffs and on December 5, 1995 concerning implementation of transmission access in power pools.

[3]Previously, the Commission also issued a notice of proposed rulemaking on information systems. Real-Time Information Networks and Standards of Conduct, Docket No. RM95-9-000, Notice of Proposed Rulemaking, 60 Fed. Reg. 66182 (December 21, 1995). PSCNY filed comments on the RIN NOPR on June 29, 1995. The Commission issued a final rule on the renamed Open Access Same-Time Information System (OASIS) in FERC Order No. 889. 61 Fed. Reg. 21737 (April 24, 1996). In this motion, PSCNY does not seek rehearing of Order No. 889.

non-bypassable retail stranded cost charges. Hence, the Commission stated:

> This Final Rule will not affect or encroach upon stats authority in such traditional areas as the authority over local service issues, including reliability of local service; administration of integrated resource planning and utility buy-side and demand-side decisions, including DSM; authority over utility generation and resource portfolios; and authority to impose non-bypassable distribution or retail stranded cost charges.[1]

Unfortunately, the Commission's final rules intrude on state authority over retail stranded costs, including retail-turned wholesale costs, and state authority over the local distribution of electricity. Moreover, the final rules should be clarified to acknowledge the states' flexibility to broker solutions to transmission access in tight power pools through the implementation of an independent system operator (ISO).

[7]

POINT I
FERC SHOULD DECLARE THAT THE STATES HAVE EXCLUSIVE AUTHORITY OVER RETAIL STRANDED COSTS

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[1] Id., at 434, n 544.

A. Congress Has Assigned the States Exclusive Jurisdiction Over Retail Stranded Costs

FERC declares in Order 888 that it has jurisdiction over retail stranded costs. The order states:

> We believe that both the Commission and the states have the legal authority to address stranded costs that result when retail customers obtain retail wheeling in order to reach a different generation supplier, and that utilities are entitled, from both a legal and a policy perspective, to an opportunity to recover all of their prudently incurred costs.[1]

The Order further states, however, that FERC will allow utilities to seek federal recovery of stranded costs caused by state-ordered retail wheeling only in limited circumstances. Hence, the Order states that the Commission will address retail stranded cost recovery only when the state regulatory authority does not have authority to address retail stranded costs.[2]

FERC's claim of authority over retail stranded costs contradicts the language of the Federal Power Act. Section 201(a) of the Federal Power Act provides that federal regulation extends to all sales of electric energy in interstate

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[1]Order 888, at 553.

[2]Id., at 8, 553.

commerce at wholesale except those **[8]** specifically exempted, and would exclude all retail sales. Federal Power Comm'n v. Southern California Edison Co., 376 U.S. 205, 211 (1964), reh'g denied, 377 U.S. 913 (1964) (emphasis added). The Supreme court has read Section 201 as drawing "a bright line easily ascertained, between federal and state jurisdiction . . ." 376 U.S. at 215. The Commission's attempt to use its power over wholesale sales to regulate the rate treatment of stranded retail[1] costs violates Congress' assignment of retail regulation to the states. Federal Power Comm'n v. Southern California Edison, 376 U.S. 205 (1964), reh'g denied, 377 U.S. 913 (1964); Federal Power Comm'n v. Florida Power & Light Co., 404 U.S. 453 (1977), reh'g denied, 405 U.S. 948 (1972); Arkansas **[9]** Electric Cooperative v. Arkansas Public Serv. Comm'n, 461 U.S. 375, 378-80 (1983).[1]

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[1]If a state utility loses $100 in revenues because a retail customer leaves the company, the fixed costs underlying the $100 remain part of the retail (state) revenue requirement, irrespective of whether the reduced usage resulted from international developments, FERC action, or purely local conditions. That is, the fact that FERC's exercise of its power over wholesale service may have led to the stranding of costs used to serve retail customers would not, in law or logic, move those costs and the revenues supporting them into FERC's jurisdiction. Similarly, if action by state agencies affects wholesale transactions, such effects cannot alter the Jurisdictional boundaries established by Congress.

[1]The Supreme Court has reiterated that the Federal Power Act was intended to leave the states' power over retail sales undisturbed, particularly insofar as it reflected the constitutional division between federal and state power existing when the Federal Power Act was passed. That division was applied to electric utilities

Inasmuch as FERC does not have jurisdiction to determine the rate treatment of costs devoted to retail service, it lacks authority to allow recovery if a state decides not to do so. As the Supreme Court noted in Connecticut Light & Power Co. v. Federal Power Comm'n, 324 U.S. 515 (1945), "the 'insulated chambers of the states' are still laboratories where many lessons in regulation may be learned by trial and error on a small scale without involving a whole national industry in every experiment." 324 U.S. at 530.

FERC's promise to invoke its claimed jurisdiction over retail stranded costs only where states lack authority to addressed stranded costs offers little solace. These statements do not eliminate the possibility that a utility which is unhappy with a state decision on stranded costs might turn to FERC to preempt the states on stranded costs using lack of authority as its pretext.

[10]

On the other hand, if FERC simply intends to provide a forum for retail stranded cost recovery where none exists at

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in Public Utilities Comm'n of Rhode Island v. Attleboro Steam & Electric Co., 273 U.S. 83 (1927), in which the Supreme Court held that a state regulatory commission could not regulate a wholesale transaction in interstate commerce. Congress filled the resulting gap by establishing federal regulation over wholesale transactions of electric utilities engaged in interstate commerce, but leaving retail intrastate transactions to the states. See Arkansas Electric Cooperative Corp. v. Arkansas Public Serv. Comm'n, 461 U.S. at 378-79 (1983).

the state level,[1] the PSCNY assumes that FERC will leave undisturbed state decisions on retail rate recovery. Consequently, PSCNY respectfully requests FERC to clarify its final rules to declare that it has no intention to review states' decisions on retail stranded investment.

POINT II

FERC SHOULD RECOGNIZE THAT STATES HAVE AUTHORITY TO DETERMINE THE LEVEL OF RETAIL-TURNED-WHOLESALE STRANDED COSTS

A. Congress has Assigned the States Exclusive Jurisdiction over Retail-Turned-Wholesale Stranded Costs

Order 888 asserts that FERC has jurisdiction to determine the rate treatment of costs stranded by the departure of retail-turned-wholesale customers. Moreover, over the dissent of Commissioners' Massey and Hoecker, the Order states that FERC should be the primary forum for addressing the recovery of these utility costs. While federal and state agencies often take actions that affect costs and revenues in each other's jurisdiction, such consequences cannot alter jurisdictional boundaries. Louisiana v. Federal Communications Comm'n, 476 U.S. 355 (1986). In Louisiana v. Federal Communications Comm'n, the **[11]** Supreme Court held that, although the states' setting of depreciation charges

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[1]It is difficult to envision a circumstance in which a state utility regulatory body has authority to order retail wheeling but lacks jurisdiction to address the rate consequences of its decision.

was alleged to frustrate a federal plan to modernize the telephone network, the Federal Communications Commission's alleged need to rectify the situation did not allow it to infringe on the states' jurisdiction.[1] Again, the Commission's attempt to use its power over transmission or wholesale sales to regulate the rate treatment of stranded retail costs (irrespective of whether the costs at issue were incurred to serve retail customers that became wholesale customers) violates Congress' assignment of retail regulation to the states. Federal Power Comm'n v. Southern California Edison, 376 U.S. 205 (1964), reh'g denied, 377 U.S. 913 (1964); Federal Power Comm'n v. Florida Power & Light Co., 404 U.S. 453 (1977), reh'g denied, 405 U.S. 948 (1972); Arkansas Electric Cooperative v. Arkansas Public Serv. Comm'n, 461 U.S. 375, 378-80 (1983).

B. FERC Should Modify Order 888 to Leave to the States the Issue of the Level of Stranded Costs to Be Recovered in Transmission Rates

In its Reply Comments on the NOPR, PSCNY offered a cooperative solution to the recovery of retail-turned-wholesale stranded costs. We proposed a process whereby the **[12]** states would set the level of retail-turned-wholesale stranded costs to be recovered in wholesale transmission rates set by FERC. This cooperative method, which was also

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[1]Specifically, in rejecting the FCC's claim that state regulation was affecting a federal program, and therefore could be preempted, the Court stressed that allowing the FCC to determine the pace of intrastate depreciation recovery "would be to grant to the agency power to override Congress." (476 U.S. at 374-375).

suggested by a number of state commissions,[1] would respect state interests in controlling the rate impact of stranded costs, while allowing FERC to design the method of cost recovery. Such a mechanism would also address the needs of industrial customers and other stakeholders by providing a forum before state regulators who will be more aware of their particular needs. Accordingly, PSCNY respectfully asks the Commission to modify Order 888 to recognize the states' jurisdiction to determine the level of retail-turned-wholesale costs.

C. FERC's "Reasonable Expectation" Standard Ignores a Series of Criteria Relevant to Retail Stranded Costs

Order 888 states that a utility seeking to recover stranded retail-turned-wholesale costs must show that when it incurred those costs, it had a "reasonable expectation" that the customers would continue to receive bundled retail service.[2] The Commission further states that it will apply the "reasonable expectation standard" to retail stranded cost recovery.[3] Such a test would ignore prudence, customer impact, financial viability and a series **[13]** of criteria traditionally analyzed by regulatory agencies in determining rate treatment of costs incurred with the intention of providing service. See Permian Basis Area Rate Cases, 390 U.S. 747 (1968), reh'g denied sub nom. Bass v. Federal Power

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[1]Order No. 888, at 534.

[2]Id., at 572.

[3]Id., at 570-71.

Comm'n, 392 U.S. 917 (1968); Market Street Railway Co. v. Railroad Comm'n of California, 324 U.S. 548 (1945); Jersey Central Power and Lioht Co. v. Federal Energy Regulatory Comm'n, 810 F.2d 1168 (D.C. Cir. 1987). The PSCNY applies these criteria to arrive at a just and reasonable balancing of consumer and investor interests. N.Y. Pub. Serv. Law S65; Matter of Abrams v. Public Serv. Comm'n, 67 N.Y.2d 205, 215 (1986).

The states are in the best position to determine the nature and level of stranded retail costs. Moreover, decisions by state regulatory agencies on recovery of retail stranded costs will be subject to judicial review under well-established standards in state courts. FERC should let the states decide the rate treatment of retail-turned-wholesale stranded costs.[1]

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POINT III

LOCAL DISTRIBUTION SHOULD BE DISTINGUISHED FROM TRANSMISSION UNDER A FUNCTIONAL STANDARD

FERC's final transmission open access rules are responsive to PSCNY'S comments that the Commission

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[1]FERC's proposal that stranded costs be administratively determined by a one-time calculation of lost revenues is, in any event, incorrect. If volumes change over, the revenues lost by the migration of a single customer will change, yet the "stranded cost" calculation will not be adjusted.

should respect state authority over local distribution.[1] Order 888 states that the Commission will not encroach upon traditional state authority to regulate the local distribution of electricity.[2] The Commission further states that it will defer to state recommendations in distinguishing local distribution facilities from equipment used for transmission in interstate commerce when states implement retail wheeling of electricity.[3] FERC pronounced that states are free to consider indicators that respect the traditional designation of facilities as transmission versus local distribution.[4] Finally, FERC says that it will respect state authority over the service of delivering electricity to end users, even if that service entails usage of transmission facilities.[5]

PSCNY appreciates FERC'e deference to state authority over local distribution of electricity. Indeed, in our state electric competition proceeding, we have ordered the seven utility members of the New York Power Pool **[15]** to provide information and filings that will assist PSCNY in distinguishing transmission and local distribution facilities in

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[1]Order 888, at 407.

[2]Id. at 427, 429.

[3]Id. at 429.

[4]Id. at 438.

[5]Id. at 433.

the integrated New York State pool.[1] Nevertheless, we disagree with the Commission's position on two related issues: 1) the Commission's deference should extend to all state commission recommendations regarding the definition of local distribution facilities; and, 2) five of the seven assumptions are inaccurate when applied to large metropolitan areas and to remote rural areas, and should be reexamined.[2]

A. FERC Should Defer in All Instances to the States in Distinguishing Local Distribution from Transmission

Regarding Commission deference to state determinations of what facilities should be considered local distribution, the Commission should not limit its deference to instances in which states order retail wheeling. The question where interstate transmission ends and local distribution begins is arising with increasing frequency. For example, in a pending petition by Suffolk County Electric Agency (SCEA) for transmission service under section 211 of the Federal Power Act, SCEA argues that transmission facilities extend to its customers' meters and, therefore, that there are no state-

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[1]N.Y.P.S.C. Opinion No. 96-12, supra, at 35, 73 (May 20, 1996).

[2]Comments of the Public Service Commission of the State of New York, August 4, 1995, at 9.

jurisdictional local **[16]** distribution facilities involved.[1] PSCNY opposed SCEA's argument and recommended that FERC defer to our expertise in analyzing local conditions to distinguish distribution facilities from interstate transmission equipment to which a section 211 wheeling order would apply.[2] FERC should modify Order 888 to state that it will defer to state expertise in distinguishing transmission from local distribution facilities.

B. State Agencies and FERC Should Agree on a Definition that Preserves the Traditional Classification of Local Distribution Facilities

1. The Rule's Assumptions Regarding Distribution Facilities Are, In Several Respects, Erroneous

In distinguishing transmission from distribution, Order 888 states that:

> 1. Local distribution facilities are normally in close proximity to retail customers;

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[1]Suffolk County Electric Agency, Docket No. TX 96-4-000, Application for Order Requiring Transmission Service (January 17, 1996), at 19.

[2]Suffolk County Electric Agency, Docket No. TX 96-4-000, Notice of Intervention by the Public Service Commission of the State of New York (February 21, 1996), at 3-6.

2. Local distribution facilities are primarily radial in character;

3. Power flows into local distribution systems; it rarely, if ever, flows out;

4. When power enters a local distribution system, it is not **[17]** reconsigned or transported on to some other market;

5. Power entering a local distribution system is consumed in a comparatively restricted geographical area;

6. Meters are based at the transmission/local distribution interface to measure flows into the local distribution system;

7. Local distribution systems will be of reduced voltage.[1]

With the exceptions of indicators 3 and 5, these assumptions are not accurate when applied to large metropolitan areas and to remote rural areas.

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[1]Order 888, at 402.

Concerning the first indicator, local distribution facilities are not necessarily close to retail customers. For example, local distribution lines cover great distances in the New York metropolitan area before voltages are stepped down to consumption levels.

With respect to the second indicator, the rules' assumption that local distribution facilities are primarily radial in character fails to account for network systems. The distribution system for large portions of many metropolitan areas (e.g., New York City, San Francisco) consists of a large grid of loops, referred to as a network system.

Regarding the fourth indicator, reconsignment or transportation of power to different markets can and does occur at the local distribution level. Again, the market **[18]** features of power transactions have little to do with the technical characteristics of local distribution grids.

With respect to the sixth indicator, meters are frequently not part of the transmission/distribution interface, and may also be present at other points in interstate transmission or local distribution systems. The presence of meters is not a discerning characteristic of where interstate transmission ends and local distribution begins.

Concerning the seventh indicator, local distribution systems are not necessarily of reduced voltage. The NOPR had stated that, based on FERC Form No. I filings, transmission facilities appeared to operate at greater than 30

kV and distribution is usually less than 40 kV.[1] That is often not the case in New York State. In rural areas of upstate New York, some lines operating at 23 kV are regarded as transmission lines. By contrast, the New York city metropolitan area operates lines at 69 kV as local distribution facilities. Order 888 did not correct this error.

2. The State/FERC Definition of Distribution Facilities Should Focus on the Functional Characteristics of Local Electric Systems

Only two of the seven technical assumptions adopted by FERC correctly define local distribution. **[19]** Specifically, interstate transmission ends and local distribution begins where: (1) electricity flows into a comparatively restricted geographic area and does not flow back out of that area, and (2) the power is consumed in that area. The Commission should simplify its seven-factor test to this functional measure of local distribution, coupled with the traditional classification of the facilities by the state regulatory body or, in the alternative, what the utility has traditionally classified as distribution. This distinction would be more workable and accurate. Accordingly, FERC should modify Order 888 to adopt the functional standard proposed by PSCNY for distinguishing transmission from local distribution.

[1]Open Access NOPR at 285 n. 396.

POINT IV

FERC SHOULD PROVIDE FLEXIBILITY IN THE FORMATION OF INDEPENDENT SYSTEM OPERATORS

Order 888 encourages the formation of independent system operators (ISOs) to assure comparable transmission access in integrated power pools, such as the New York Power Pool. The Commission sets forth eleven principles to guide the formation of ISOs.[1] PSCNY shares FERC's vision that an ISO is the appropriate structure for assuring comparable transmission access where tight power pools exist. An ISO will also ensure safe and reliable service and the infrastructure for effective retail competition in New York. Accordingly, in its order on restructuring the electric industry, PSCNY stated that it expects the seven electric **[20]** and combination utilities and the New York Power Authority to complete a proposal for establishing an ISO for New York by October 1, 1996.[1]

The ISO principles do not provide adequate flexibility for establishing an ISO that will meet New York's needs. For example, in its first principle, FERC states that "The ISO's governance should be structured in a fair and non-discriminatory manner".[2] In interpreting this principle, the

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[1]Order 888, at 279-86.

[1]N.Y.P.S.C. Opinion No. 96-12, supra, at 35, 73 (May 20, 1996).

[2]Order No. 888, at 280.

commission states that an ISO should be independent of market participants, including control by transmission owners.[3] Accordingly, FERC would apparently reject an ISO proposal that provided for governance by transmission owners.

The parties to New York's electric competition proceeding[4] are discussing formation of an ISO with the following features:

1. Market pricing rules are established by a multi-party board that is not under the control of any one class of market participant;

[21]

2. The establishment and implementation of reliability rules and market rules is handled by a system operator controlled by transmission owners that have divested competitive generation; and,

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[3] Id.

[4] N.Y.P.S.C. Case 94-E-0951, In the Matter of Competitive Opportunities Regarding Electric Service. The parties to the New York State proceeding have been discussing formation of an ISO for the integrated New York Power Pool for several months. PSCNY has not received or approved any ISO proposal to date.

3. Transmission owners would recover full embedded costs independent of generation dispatch or transmission system operation, so that transmission owners would have no vested interest in decisions on access to, or operation of, the transmission system.

Even though under this proposed model the transmission owners control the system operator, it appears to be consistent with FERC's first ISO principle of fair and non-discriminatory governance because the transmission owners would own no competitive generation. Although the NYPSC has made no decisions on ISO governance, it would not like to see this or other options foreclosed. Consequently, to ensure the formation of an ISO that meets the shared objectives of FERC and PSCNY, the Commission should clarify Order 888 to state that it will allow flexibility to states and utilities in structuring proposals that meet the goals underlying the ISO principles.

CONCLUSION

For the reasons stated above, the Federal Energy Regulatory commission should grant the motion for rehearing of the Public Service Commission of the State of New York **[22]** and modify the final rules contained in order 888 as indicated.

Respectfully submitted,

/s/_____

Maureen O. Helmet
General Counsel
New York State Public
Service Commission
Lawrence G. Malone
Solicitor
Carl F. Patka
Assistant Counsel
Three Empire State Plaza
Albany, New York 12223-1350

DATED: May 24, 1996
Albany, New York

REQUEST OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS FOR REHEARING

[p. 1]

BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION
Washington, D.C.

[Filed May 24, 1996]

Docket Nos. RM95-8-001 and RM94-7-002

Promoting Wholesale Competition	)
Through Open Access	)
Non-discriminatory Transmission	)
Services by Public Utilities	)
	)
Recovery of Stranded Costs	)
By Public Utilities and	)
Transmitting Utilities	)
	)

REQUEST OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS FOR REHEARING

Pursuant to Rule 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §385.713, the National Association of Regulatory Utility Commissioners (NARUC) hereby requests rehearing of Order No. 888 issued by the Federal Energy Regulatory Commission (FERC or the

Commission) in the above-captioned proceeding on April 24, 1996. 60 Fed. Reg. 21540 et seq. (May 10, 1996).

CONCISE STATEMENT OF ALLEGED ERROR

The NARUC respectfully submits that Order No. 888 contains the following errors that should be corrected upon rehearing:

- The Commission's assertion of exclusive jurisdiction over transmission services provided retail consumers on an unbundled basis is inconsistent with the Federal Power Act's allocation of jurisdictional authority between the Commission and the States;

- The Commission's assertion of "primary" authority to provide for the recovery of retail costs of service that are "stranded" when a group of end-users convert to wholesale customers under procedures established in State law exceeds the Commission's authority under the Federal Power Act;

* * * * *

[4]

B. The Commission Should Reverse its Assertion of Jurisdiction over the Rates, Terms and Conditions of Unbundled Retail Transmission Services

In Order No. 888, the Commission restates its conclusion that "it has exclusive jurisdiction over unbundled retail transmission in interstate commerce by public utilities." Slip op. at 400. We respectfully submit that this conclusion is erroneous, and urge its reversal on rehearing for the following reasons.

First, as the Commission notes, the allocation of jurisdiction between the Commission and the States enacted by Congress in both the Federal Power and Natural Gas Acts

> grew out of a market structure in which electricity and transmission generally were bought and sold on a bundled basis. As a result, most transactions included either a retail or wholesale sale of electric energy and jurisdictional lines were drawn on the basis of this sale. Thus, the cases [construing these statutes] simply do not resolve dispositively these jurisdictional issues when they arise in the context of the market structures and unbundled transactions being contemplated in today's electric industry.
>
> Id. at 428 (emphasis added)

Moreover, ambiguous case law is not the only problem in analyzing this jurisdictional question. As the Commission stated in March 1995 in the Notice of Proposed Rulemaking (NOPR) in this docket, the legislative history of the Federal Power Act "does not provide any definitive answers" as well. NOPR at 258.[2]

As NARUC stated in its October 4, 1995 reply comments (at 5-7), we agree with the Commission that the FPA's allocation of jurisdictional responsibility was designed in a far different regulatory era to address a very specific problem: filling the so-called Attleboro gap **[5]** in which States were found incapable of regulating interstate wholesale power sales transactions.[3] We further agree that the case law of that era is not dispositive concerning the question of unbundled retail transmission services either because the cases do not involve the transmission of power to retail customers[4]

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[2]While including some analysis in the preamble to Order 888, the FERC included as Appendix G to Order No. 888 the bulk of its legal analysis of its exclusive authority over the rates, terms and conditions of unbundled retail transmission. While the Commission believes that the statute is clear on its face as to this issue, it attempts to buttress its analysis by relying on this ambiguous legislative history and out-dated case law.

[3]Public Utilities Commission v. Attleboro Steam & E. Co., 273 U.S. 83 (1927).

[4]Jersey Central Power & Light Co. v. FPC, 319 U.S. 61 (1943); FPC v. Southern California Edison Co., 376 U.S. 205 (1964) (the Colton case); Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission, 461 U.S. 375 (1983).

or fence off local distribution from Federal regulation.[5] As the Commission acknowledged in the NOPR (at 266-8), at least one Court of Appeals, relying on Congress' intent to close the Attleboro gap concerning wholesale power sales, explicitly applied the wholesale/retail distinction to distinguish transmission and local distribution services, lending support to NARUC's claim that the Commission should apply the same analysis -- wholesale versus retail -- to the question of unbundled retail transmission.[6]

Second, we agree that the legislative history is not helpful in resolving this jurisdictional question, and provides little support for the Commission's conclusion that the act of unbundling generation from delivery serves to shift jurisdiction from a State commission to the FERC. If anything, the jurisdictional structure of the FPA is predicated on the distinction between retail and wholesale transactions, not bundled and unbundled services as the Commission concludes. Indeed, as recently as 1992 when it enacted the Energy Policy Act (EPAct), Congress reaffirmed the wholesale/retail distinction when it amended section 212 of the FPA to prohibit the **[6]** Commission from issuing orders that require transmission of electric energy to a retail consumer, or that are or would be otherwise inconsistent with State-regulated retail marketing areas of electric utilities. §§212(g) and (h). Moreover, in EPAct, Congress included a specific provision protecting State authority "concerning the

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[5]Connecticut Light & Power Co. v. FPC, 334 U.S. *515* (1945); Duke Power Co. v. FPC, 401 F.2d 930 (D.C. Cir. 1968).

[6]Wisconsin-Michigan Power Co. v. FPC, 197 F.2d 472 (7th Cir. 1952), cert. denied, 345 U.S. 934 (1953).

transmission of electric energy directly to an ultimate consumer" from interference by the Commission's newly-expanded authority to order wholesale transmission services. §212(h).

Third, the seven-factor test that the Commission adopts in Order No. 888 (at 435-6) to apply to the transmission/distribution analysis creates the further difficulty that it does not result in the "bright line" of the sort that the Supreme Court discussed in the Colton case where the wholesale versus retail dichotomy was perhaps most definitively expressed. Rather, the Commission's test necessarily involves a facility-by-facility categorization of utility systems on a company-specific basis, a process hardly consistent with the Court's decision to "mak[e] unnecessary such case-by-case analysis." 376 U.S. at 214.

Accordingly, the NARUC again urges the Commission to adopt on rehearing a test that results in no change in the allocation of jurisdiction between FERC and the States in the retail wheeling/customer choice case from the situation in which electric energy is provided an end user by the utility supplying the delivery service. The Commission should conclude that the rates, terms and conditions of service for delivery of power by a utility to an end-use customer is subject to the jurisdiction of the State commission regulating the utility, regardless of the identity of the party generating or reselling the power or the facilities used to transport the power.

[7]

There would be a number of important benefits if this proposal were adopted. First, the Commission would be

implementing a bright line test: delivery of electric energy to an end user would be State-jurisdictional regardless of who generates or supplies the power.[7] As a result, the Court's admonition in Colton against case-by-case analysis as required by Order No. 888 would be heeded. Importantly, a jurisdictional test which focusses on the retail status of the customer receiving the delivery service is entirely consistent with Colton's analysis of wholesale and retail power sales. To the extent that Colton demands a bright-line test as a matter of law, this proposal is one of the few workable and easily understood alternatives, given that under no conceivable analysis can the Commission conclude that the delivery of third-party power to an end user is exclusively FERC-jurisdictional, i.e., never involves a State-jurisdictional distribution component.

Finally, we submit that a decision which definitively clarifies jurisdiction over delivery of third-party power to an end user in the manner we have suggested will actually

---

[7]In, Order No. 888, the Commission appears to conclude that a State-established program allowing for retail customers to choose their source of generation necessarily results in the creation of an unbundled transmission service, and hence effects a shift in jurisdiction from the State commission to the FERC. Slip op. at 430-1. The commission does not address the point we raised in our reply comments as to how the removal of generation serves to unbundle the retail delivery function into separate transmission and distribution services. Id. Without any real explanation, the Commission simply assumes -- erroneously in our view -- that a "resulting transmission transaction" is created when power sale is sold to a retail consumer by someone other than the utility delivering the power.

promote the Commission's competitive goals. While Order No. 888 does provide certain assurances that the Commission will be sensitive to State initiatives, it remains a distinct possibility that States which might consider implementing pro-competitive customer choice programs will be hesitant **[8]** to do so due to their concern that their commissions will be precluded from regulating much (or any) of the retail delivery service provided by the utility.

In sum, the NARUC submits that for sound legal and practical reasons, the Commission should conclude that when a State determines to enable a retail consumer to purchase power from a third-party provider, its State commission retains the authority to regulate the rates, terms and other conditions of the delivery service provided by the utility to that consumer.

C. The Recovery of Retail Stranded Costs, in Either the Retail-turned-Wholesale or Retail Wheeling Case is Subject to the Exclusive Jurisdiction of the States

The NARUC once again respectfully requests that on rehearing, the Commission withdraw that portion of Order No. 888 which provides utilities the opportunity to apply to FERC to recover so-called "retail stranded costs." The Commission lacks the legal authority either to take "primary jurisdiction" in the retail-turned-wholesale case, or to act as a backstop in the retail wheeling case when a State lacks authority to address the issue. Accordingly, FERC must leave the identification, measurement, allocation and recovery of the costs incurred by a utility to serve its retail customers for the State legislatures and commissions to resolve.

Under section 201(a) of the FPA, FERC's jurisdiction is limited to 'the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce," and further, extends "only to those matters which are not subject to regulation by the States." Further, section 201(b) of the statute expressly excludes from the Commission's authority "facilities used for the generation of electric energy" as well as distribution facilities. Costs incurred by a utility to serve its retail customers, whether they be the costs of utility-owned generation facilities, demand-side management programs, "QF" contracts, or so-called **[9]** "regulatory assets," do not involve the sale of electric energy at wholesale nor interstate transmission services, and are therefore not apprehended by the Commission's wholesale sales and transmission jurisdiction. And since both of the scenarios in which FERC is prepared to act to authorize cost recovery (i.e., "municipalization" and retail wheeling) cannot occur without reliance upon the operation of State laws and regulations, it simply cannot be the case that the recovery of retail costs by a utility is "not subject to regulation by the States."

We have not ignored the fact that FERC's jurisdiction under section 201 has been given an expansive construction in judicial opinions issued since the FPA was enacted 60 years ago, nor do we doubt that "electrons do not respect State boundaries." However, even the broadest reading of section 201 cannot provide FERC jurisdiction over unamortized <u>generation</u> (or other) costs held in retail rate base (or otherwise subject to recovery in retail rates) for no other reason than an arguably jurisdictional <u>transmission</u> service provides the Commission a "toll booth" for the recovery of costs that would otherwise be beyond its grasp.

The lack of Commission authority under the FPA to address retail costs applies across the board; however, there are some differences between the two cases (municipalization and retail wheeling) to which we now turn.

APPLICATION OF THE COALITION FOR A COMPETITIVE ELECTRIC MARKET FOR RECONSIDERATION AND CLARIFICATION OR, IN THE ALTERNATIVE, REHEARING

[p. 1]

UNITED STATES OF AMERICA
Before The
FEDERAL ENERGY REGULATORY COMMISSION

[Filed May 24, 1996]

Docket Nos. RM95-8-001 and RM94-7-002

NOTICE OF PROPOSED	)
RULEMAKING	)
REGARDING PROMOTING	)
WHOLESALE COMPETITION	)
THROUGH OPEN ACCESS	)
NON-DISCRIMINATORY	)
TRANSMISSION SERVICES BY	)
PUBLIC UTILITIES	)
	)
SUPPLEMENTAL NOTICE OF	)
PROPOSED RULEMAKING	)
REGARDING RECOVERY	)
OF STRANDED COSTS BY	)
PUBLIC UTILITIES AND	)
TRANSMITTING UTILITIES	)
	)

APPLICATION OF THE COALITION FOR A COMPETITIVE ELECTRIC MARKET FOR RECONSIDERATION AND CLARIFICATION OR, IN THE ALTERNATIVE, REHEARING

Jeffrey D. Watkiss
Sam R. Hananel
Tracey L. Bradley
Bracewell & Patterson, L.L.P.
2000 K Street, NW
Fifth Floor
Washington, D.C. 20006-1872

May 24, 1996

* * * * *

[pp. 4-8]

[4]

REQUEST FOR REHEARING

I. DEPARTURES FROM SERVICE COMPARABILITY

A. All Transmission Must Be Unbundled

1. Transmission to retail customers -- The Commission wisely questioned in the underlying notice of proposed rulemaking whether undue discrimination can be eradicated in a "bifurcated" market in which transmission for wholesale is unbundled and transmission for retail is not:

> This will result in service under two separate arrangements -- an explicit wholesale transmission tariff filed at the Commission and an *implicit* retail transmission tariff governed by a state regulatory body. It also raises the possibility that the quality of transmission service for retail purposes will be superior to the quality of transmission service offered for wholesale purposes.

Notice of Proposed Rulemaking Regarding Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities, 60 Fed. Reg. 17,662 at 17,681 (1995) (emphasis added) [hereinafter, "NOPE"]. Despite the Commission's recognition of this risk of service inequality, and its further recognition in the Rule that unbundling transmission from retail service "would be helpful in achieving comparability," Order, 61 Fed. Reg. at 21,577, it fails to require that all transmission service be unbundled from retail services. This failure is arbitrary and irreconcilable with the Commission's concurrent determination in connection with the rules pertaining to stranded-cost recovery that it has jurisdiction over the rates, terms and conditions of **[5]** unbundled interstate transmission services by public utilities to retail customers, and that it has the authority to address retail stranded costs through its jurisdiction over such services. Order. 61 Fed. Reg. at 21,650. Commission jurisdiction over *all* transmission has a solid legal foundation. Because of the manner in which electric power flows, the Supreme Court repeatedly has affirmed that virtually all transmission is in interstate

commerce.[2] Granted, the Commission heretofore has not exercised its Federal Power Act ("FPA") authority to regulate transmission to a retail customer. This does not negate the existence of the Commission's authority.

Perpetuation of a discriminatory dual market, absent *complete* unbundling, finds a clear parallel in the Commission's experience from restructuring the natural gas industry. Following introduction of open-access transportation via Order No. 436, service comparability continued to elude gas markets:

> [T]he firm transportation embedded within the *pipelines' bundled, city-gate, firm sales service is superior* to the pipeline's open-access firm transportation service. This means that pipelines and other gas suppliers are not competing on an even basis for sales customers, even where firm transportation is available to move the gas sold by the pipelines' competitors.

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[2] *E.g., FPC v. Florida Power & Light Co.*, 404 U.S. 453, 463 (interstate power "commingles in a bus"), *reh'g denied*, 405 U.S. 948 (1972); *FPC v. Southern California Edison Co.*, 376 U.S. 205, 215-16, *reh'g denied*, 377 U.S. 913 (1964); *Connecticut Light & Power Co. v. FPC*, 324 U.S. 515, 533, 536 (1945); *see also Florida Power & Light Co.*; 29 F.E.R.C. ¶61,140 at 61, 291(1984) ("transportation of power [on] grid . . . used in interstate commerce is subject to this Commission's jurisdiction, even when all the parties to the wheeling transaction are located within the same State").

[6]

Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines after Wellhead Decontrol, Order No. 636, 57 Fed. Reg. 13,267 (1992), [Regs. Preambles] III F.E.R.C. Stats. & Regs. ¶30,939 at 30,402 (1992) (emphasis added) [hereinafter "Order No. 636"]. Ultimately, in order to achieve "an even basis for competition," the Commission in Order No. 636 was compelled to unbundle transportation completely, not only from the pipeline's citygate wholesales, but also from the pipeline's direct retail sales. *See* 18 C.F.R. §284:10 (1994) (requiring pipelines to phase in conversion rights for all firm sales service customers whose contracts preceded Order No. 436).

Just as open access *alone* did not uproot inequality between unbundled transportation provided to third-party shippers and the bundled transportation that the pipelines provided to themselves to make citygate sales, the *pro forma* tariffs *alone* cannot establish comparability between the transmission service that a public utility provides to its retail sales functions and the wholesale transmission services that it provides to others. Ineluctably, discrimination will persist until there is total unbundling and consumers *of all* transmission services, wholesale and retail, take service pursuant to the same tariff at posted rates. The Commission's authority *and responsibility* under the FPA to address such discriminatory differences between wholesale and retail markets is well established in the prevailing decisional precedents. *See FPC v. Conway Corp.*, 426 U.S. 271, 273 (1976).

[7]

The failure to unbundle transmission to retail customers is also squarely at odds with the Commission's decisional precedents under the Natural Gas Act CNGA"). In *Mississippi River Transmission Corp. v. FERC,* 969 F.2d 1215 (D.C. Cir. 1992), the court affirmed the Commission's interpretation of NGA section 1 (b), 15 U.S.C. §717(b) (I 988), as authorizing the Commission to regulate the price of transportation service that MET provided in support of certain firm direct sales. In relevant part, NGA section 1 (b) is identical to FPA section 201(b): "The provision of this chapter shall apply to the transportation of natural gas in interstate commerce . . . ." Based on this broad grant of jurisdiction, the court held that:

> FERC is not barred from regulating a pipeline's interstate transportation of natural gas merely because the sale of the gas being transported is not itself subject to federal regulation. FERC's authority over such transactions is beyond dispute.

969 F.2d at I217 (citing *FPC v. East Ohio Gas Co.,* 338 U.S. 464, 468 (1950)); *accord Alabama Tennessee Natural Gas Co.,* 64 F.E.R.C. ¶61,084 at 61,846 (1993); *Carnegie Natural Gas Co.,* 63 F.E.R.C. ¶61,103 at 61,612 (1993). In reaching this conclusion, the court rejected MET's contention that the Commission's NGA §1(b) jurisdiction to regulate the price, terms and conditions of interstate transportation is divested whenever the subject transportation is bundled with

a non-jurisdictional sale.[3] The court found this contention untenable because it would invite manipulation:

[8]

> As far as the statute is concerned, there would be no doubt of FERC's section l(b) authority if MRT, instead of charging a bundled price, had charged separately for the gas itself. To accept MRT's position would therefore be tantamount to conferring on private parties the power to decide whether FERC could set the rate for interstate transportation. Private parties would have this power because it would be entirely up to them whether to structure a direct sale and interstate transportation transaction in terms of a bundled price or separate charges.

Id. at 1218. Just as the Commission's NGA section l(b) jurisdiction to regulate natural gas transportation to retail customers was "beyond dispute" in *Mississippi River,* it is equally beyond dispute that the Commission possesses FPA section 201(b)jurisdiction to unbundle and regulate electricity transmission in interstate commerce to a retail customer.

---

[3]The NGA and the FPA are different with respect to the certificate of public convenience and necessity (" PC&N") that a natural gas company must obtain under NGA §7, 15 U.S.C. §717f(c) (1988), in advance of providing any jurisdictional service. There is no analog to the PC&N process in the FPA. The Commission's §7 jurisdiction over transportation was not contested in *Mississippi River*. *See* 969 F2d at 1217. Rather, only the Commission's authority under §1(b) to regulate the price of gas pipeline transportation to retail customers was at issue.

In sum, there is no rational basis for regulating factually undifferentiated uses of the transmission lines differently. Achieving and policing comparability will require the Commission to go beyond artificial distinctions between wholesale and retail transactions and insist that all transmission providers and customers confront the same unbundled market.

FEDERAL ENERGY REGULATORY COMMISSION
ORDER 888-A

[Issued March 4, 1997]

Docket Nos. RM95-8-0001and RM94-7-002

Order No. 888-A

* * * * *

[pp. 30,172 - 30,182]

[30,172]
62 F.R. 12274 (March 14, 1997)

18 C.F.R. Part 35

Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities

AGENCY: Federal Energy Regulatory Commission.

ACTION: Final rules; order on rehearing.

SUMMARY: The Federal Energy Regulatory Commission (Commission) reaffirms its basic determinations in Order No. 888 and clarifies certain terms. Order No. 888 requires all public utilities that own, control or operate facilities used for transmitting electric energy in interstate commerce to have on file open access non-discriminatory transmission tariffs that contain minimum terms and conditions of non-discriminatory service. Order No. 888 also permits public utilities and

transmitting utilities to seek recovery of legitimate, prudent and verifiable stranded costs associated with providing open access and Federal Power Act section 211 transmission services. The Commission's goal is to remove impediments to competition in the wholesale bulk power marketplace and to bring more efficient, lower cost power to the Nation's electricity consumers.

EFFECTIVE DATE: Changes to Order No. 888 made in this order on rehearing will become effective on [insert date 60 days after date of publication in the *Federal Register*].

FOR FURTHER INFORMATION CONTACT: David D. Withnell (Legal Information -- Docket No. RM95-8-001), Office of the General Counsel, Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426, (202) 208-2063

Deborah B. Leahy (Legal Information -- Docket No. RM94-7-002), Office of the General Counsel, Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426, (202) 208-2039

Dan T. Hedberg (Technical Information -- Docket No. RM95-8-001), Office of Electric Power Regulation, Federal Energy Regulatory Commission, 888 First Street, N.E. Washington, D.C. 20426, (202) 208-0243

Joseph M. Power (Technical Information -- Docket No. RM94-7-002), Office of Electric Power Regulation, Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426, (202) 208-1242

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contractor, La Dorn Systems Corporation. La Dorn Systems Corporation is also located in the Public Reference Room at 888 First Street, N.E., Washington, D.C. 20426.

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I. Introduction and Summary

On April 24, 1996, the Commission issued Final Rules (Order Nos. 888 and 889) intended to remedy undue discrimination in the provision of interstate transmission services by public utilities and to address the stranded costs that may result from the transition to more competitive electricity markets.[1] At the heart of these rules is a requirement that prohibits owners and operators of monopoly transmission facilities from denying transmission access, or

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[1]Promoting Wholesale Competition Through Open Access Non- discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, 61 FR 21,540 (May 10, 1996), *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* ¶31,036, *clarified*, 76 FERC ¶61,009 and 76 FERC ¶61,347 (1996). Order No. 889 [*FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* ¶31,035], is an accompanying rule and specific rehearing arguments on that rule will be addressed separately.

offering only inferior access, to other power suppliers in order to favor the monopolists' own generation and increase monopoly profits -- at the expense of the nation's electricity consumers and the economy as a whole.

The electric utility industry today is not the industry of ten years ago, or even **[30,176]** five years ago. While historically it was assumed that local utilities would be the only ones to generate and transmit power for their customers, today there is a broad array of potential competitors to supply power and widespread transmission facilities that can carry power vast distances. But competitors cannot reach customers if they cannot have fair access to the transmission wires necessary to reach those customers. It is against this industry backdrop that the Commission in Order No. 888 exercised its public interest responsibilities pursuant to sections 205 and 206 of the Federal Power Act (FPA), to reexamine undue discrimination in interstate transmission services and the effect of that discrimination on the electricity customers whom we are bound to protect under the FPA.

We here reaffirm the legal and policy bases on which Order No. 888 is grounded. Utility practices that were acceptable in past years, if permitted to continue, will smother the fledgling competition in electricity markets and undermine the national policies reflected in the Energy Policy Act of 1992 to encourage the development of competitive markets. We firmly believe that our authorities under the FPA not only permit us to adapt to changing economic realities in the electric industry, but also require us to do so, as necessary to eliminate undue discrimination and protect electricity customers. The record supports our conclusion that, absent open access, undue discrimination will continue to be a fact

of life in today's and tomorrow's electric power markets. As recent events clearly demonstrate, unbundled electric transmission service will be the centerpiece of a freely traded commodity market in electricity in which wholesale customers can shop for competitively-priced power.

The only way to effectuate competitive markets and remedy discrimination is through readily available, non-discriminatory transmission access. The Commission estimates the potential quantitative benefits from such access will be approximately $3.8 to $5.4 billion per year in cost savings, in addition to the non- quantifiable benefits that include better use of existing assets and institutions, new market mechanisms, technical innovation, and less rate distortion.

Order No. 888 has two central components. The first requires all public utilities that own, operate or control interstate transmission facilities to offer network and point-to-point transmission services (and ancillary services) to all eligible buyers and sellers in wholesale bulk power markets, and to take transmission service for their own uses under the same rates, terms and conditions offered to others. In other words, it requires non-discriminatory (comparable) treatment for all eligible users of the monopolists' transmission facilities. The non-discriminatory services required by Order No. 888, known as open access services, are reflected in a pro forma open access tariff contained in the Rule. The Rule also requires functional separation of the utilities' transmission and power marketing functions (also referred to as functional unbundling) and the adoption of an electric transmission system information network.

The second central component of Order No. 888 was to address whether and how utilities will be able to recover costs that could become stranded when wholesale customers use the open access tariffs, or FPA section 211 tariffs,[2] to leave their utilities' power supply systems and shop for power elsewhere. Because of competitive changes occurring at the retail level, as numerous states have begun retail transmission access programs, Order No. 888 also clarifies whether and when the Commission may address stranded costs caused by retail wheeling and the extent of the Commission's jurisdiction over unbundled retail transmission. The Commission further addresses the circumstances under which utilities and their wholesale customers may seek to modify contracts made under the old regulatory regime, taking into account the goals of reasonably accelerating customers' ability to benefit from competitively priced power and at the same time ensuring the financial stability of electric utilities during the transition to competition.

[30,177]

137 entities filed requests for rehearing and/or clarification of Order No. 888. While these parties raise a variety of arguments -- including legal, policy, and technical arguments -- the majority (including a majority of public utilities) agree that we need to harness the benefits that competitive electricity markets can bring to the nation. The

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[2]Under section 211 of the FPA, the Commission, on a case-by- case basis upon application by an eligible customer, may order both public utilities and non-public utilities that own or operate transmission facilities used for the sale of electric energy at wholesale to provide transmission services to the applicant if it finds it is in the public interest to issue such order.

disagreements primarily focus on the mechanics of how we should do this, who should pay the costs of the transition to competition, and how long the transition should take.

First, parties disagree on what is necessary to remedy undue discrimination and to develop truly competitive wholesale markets. Many focus specifically on the tariff terms and conditions of good transmission access and seek changes in the Order No. 888 pro forma tariff. In response to these types of rehearing arguments, the Commission has fine-tuned or changed some of the pro forma tariff terms and conditions to better ensure that they do not permit discrimination and that they result in well-functioning markets. Other petitioners focus on additional structural changes which they believe are necessary, such as mandatory corporate restructuring (divestiture of generation assets) or mandatory creation of independent transmission system operators (ISOs). With regard to restructuring, the Commission continues to believe that functional unbundling of the utility's business, not corporate divestiture or mandatory ISOs, is sufficient to remedy undue discrimination at this time.

The most contentious arguments raised on rehearing involve how we deal with the transition costs associated with moving to competition. Some utilities have invested millions of dollars in facilities and purchased power contracts based on an explicit or implicit obligation to serve customers and the expectation that those customers would remain on their systems for the foreseeable future. These utilities face so-called "stranded costs" which, if not recovered from the customers that caused the costs to be incurred, could be shifted to other customers.

There are two basic categories of rehearing arguments regarding stranded cost recovery. Most utilities want a guarantee from this Commission that they will recover all stranded costs, whether caused by losing retail customers or wholesale customers. Many customers, on the other hand, want to be able to abrogate existing power supply contracts so that they can immediately leave their current suppliers' systems and shop for cheaper power elsewhere, without paying the sunk costs that their suppliers incurred on their behalf.

In response to these diverse arguments, the Commission has struck a reasonable balance that, for certain defined circumstances, permits utilities the opportunity to seek extra-contractual recovery of stranded costs from their departing customers and permits customers the opportunity to make a showing that their contracts should be shortened or terminated. Based on our experience in the natural gas area, we have learned that it is critical to address these issues early, but we also have chosen an approach different from that taken in the gas area because of the different circumstances facing the electric industry.

In balancing the wide array of interests reflected in the rehearing petitions, we have made a number of clarifications and granted rehearing on some issues, but we reaffirm the core elements and framework of Order No. 888. Since the time the final rules issued, as discussed in Section III, the pace of competitive change has continued to escalate in the industry at both the wholesale and retail levels as competitors, customers and state regulatory authorities aggressively seek ways to lower the price of electricity. We therefore believe it is all the more critical that we remedy undue discrimination

in interstate transmission services now, and that we do so generically, if we are to fulfill our responsibilities under the FPA to protect consumers and provide a fair and orderly transition to new competitive markets.

Finally, with respect to environmental issues associated with this rulemaking, certain parties on rehearing continue to challenge the adequacy of our Final Environmental Impact Statement (FEIS). The central issues are whether the Final Rule will increase emissions of nitrogen oxides (NO_x) from certain fossil-fuel fired generators, which could affect air quality in downwind areas to which these emissions may be carried, and the Commission's authority to mitigate environmental consequences.

[30,178]

We deny rehearing on the environmental issues raised and affirm our conclusion that we have satisfied our obligations under NEPA. As discussed in detail in the Final Rule, this rulemaking is expected to slightly increase or slightly decrease total future NO_x emissions, depending on whether competitive conditions in the electric industry favor the utilization of natural gas or coal as a fuel for the generation of electricity. We also examined mitigation options over the longer term, and found that the preferred approach for mitigating any adverse environmental consequences would be for the Environmental Protection Agency (EPA) and the states to address the problem through regulatory authorities available under the Clean Air Act. The petitions for rehearing have not persuaded us to change this approach. Indeed, we note that since the issuance of Order No. 888, the EPA has concluded that the Rule is unlikely to have any immediate significant adverse environmental impact and thus concurred

that the Commission's analysis is adequate under NEPA. We further note that EPA has recently taken steps under the Clean Air Act to address NOx emissions as part of a comprehensive emissions control program, along the lines endorsed by the Commission in the EIS.

In summary, the Commission believes that our authorities under the FPA not only permit us to adapt to changing economic realities in the electric industry, but also require us to do so to eliminate undue discrimination and protect electricity customers. The measures required in Order No. 888 are necessary to remedy undue discrimination in interstate transmission services and provide an orderly and fair transition to competitive bulk power markets.

To assist the reader, we provide below a section-by-section summary of key elements of this Order on Rehearing.

Scope of the Rule

In this section we discuss petitions to rehear our requirement that transmission and power sales services be contracted for separately (unbundled). We reaffirm that this requirement is a reasonable and workable means of assuring non- discriminatory open access transmission. In doing so we refuse invitations to require that utilities under our jurisdiction divest themselves of generation or transmission assets. We do, however, make an important clarification involving how we will deal with existing contracts that contain so-called Mobile-Sierra clauses (clauses under which one or both parties agreed not to seek modification of contract terms unless they could show that it is contrary to the public interest not to permit the modification).

In Order No. 888 we concluded that contracts would not be abrogated by operation of the Rule. Instead, preexisting contracts would continue to be honored until such time as they were revised or terminated. We also found that those who were operating under pre-existing requirements contracts containing *Mobile-Sierra* clauses would nonetheless be allowed to seek reform of the contracts on a case-by-case basis. On rehearing we affirm that public utilities will be allowed to file to amend their *Mobile-Sierra* contracts for the limited purpose of providing an opportunity to seek recovery of stranded costs, without having to make a public interest showing that such cost recovery should be permitted. However, these utilities will have the burden, on a case-by-case basis, of showing that they had a reasonable expectation of continuing to serve the departing customer after the contract term. We clarify that if the utilities under such contracts seek to modify provisions that do not relate to stranded costs, they will have the burden of showing that the provisions are contrary to the public interest.

We here make clear that, in turn, customers will be allowed to file to amend their *Mobile-Sierra* contracts to modify any contract term or to terminate the contract, without having to make a showing that the contract terms are contrary to the public interest. Instead, customers seeking modifications must demonstrate that the provisions they wish modified are no longer "just and reasonable." We reaffirm our conclusion in the Final Rule that if a customer seeks to shorten or eliminate the term of its contract, however, any contract modification approved by the Commission will provide for appropriate stranded cost recovery by the customer's supplying utility.

These various provisions meet the two-fold need to deal with stranded costs and the contracts under which those costs were incurred. However, as described in **[30,179]** Order No. 888, the opportunity to reform Mobile-Sierra contracts extends only to a limited set of contracts -- those entered into on or before July 11, 1994, for requirements power.

Comparability

In this section we deal with those requesting rehearing of our conclusions regarding what "comparable" service is, who is eligible for that service, and how it is to be implemented. We reaffirm our finding that, as a matter of law, we have jurisdiction over the rates, terms and conditions of unbundled transmission service provided to retail customers. We also clarify that we have authority to order "indirect" unbundled retail transmission services and that if such transmission is ordered by us in the future, or if it is provided voluntarily, otherwise eligible customers may obtain such service under the open access tariff. We expect public utilities to provide such service in the future and, if they do not, we will not hesitate to order it.

We modify in two respects the definition of who is eligible for open access transmission service. First, we clarify that, with respect to service that this Commission is prohibited from ordering by section 212(h) of the Federal Power Act (retail wheeling directly to an ultimate consumer and "sham" wholesale wheeling), entities are eligible for such service under the tariff only if it is provided pursuant to a state requirement or is provided voluntarily. Second, we clarify that retail customers taking unbundled service pursuant to a state requirement (i.e., direct retail service) are eligible for

such service only from those transmission providers that the state orders to provide service. These changes are made to make clear that our rules cannot be used to circumvent the proscriptions placed on the Commission against ordering direct retail wheeling.

Ancillary Services

In this section we deal with petitions to rehear our definitions of ancillary services -- those services such as scheduling, voltage control, and supplemental reserve service that must or can attend the providing of transmission service -- as well as the provisions involving these services. We reaffirm that tariffs must separately state the charges for these services. We do modify some of the definitions of these services to conform to industry needs and practices. Most importantly, we make clear that the transmission provider's sale of ancillary services associated with providing basic transmission service is not a wholesale merchant function and thus does not violate the standards of conduct imposed with Order No. 889.

Coordination Arrangements

The requirement to provide non-discriminatory open access transmission applies to any agreement between utilities that contains transmission rates, terms or conditions. This includes pooling arrangements and agreements between companies contracting to provide each other mutually beneficial transmission services. In Order No. 888 we laid out rules under which the open access comparability requirements would apply to tight and loose power pools, public utility holding companies and bilateral coordination agreements. We

also set out principles that would govern our approval of independent system operator (ISO) agreements.

In this section we affirm the rules governing coordination agreements. In doing so we clarify the definition of "loose pool." We also make clear that, unlike in other situations where we require utilities to provide not only the services they provide themselves but those they could provide themselves, we will require members of loose pools to offer to third parties only those transmission services that they provide themselves under their pool-wide agreements.

We also reaffirm our strong commitment to the concept of ISOs and the ISO principles described in Order No. 888. In doing so we reject arguments that we should require that ISOs be formed. At the same time, we emphasize that while there is no "cookie-cutter" approach to forming an acceptable ISO, the requirement of fair and non-discriminatory rules of governance (Principle One) and the requirement that ISO employees have no financial interest in the economic interests of power marketers - - backed by strict conflict of interest provisions -- (Principle Two) are fundamental to our approving any ISO.

Pro Forma Tariff Provisions

The *pro forma* tariff is the basic mechanism implementing the requirements of comparable open access transmission. It **[30,180]** provides the details of the transmission service obligations imposed on jurisdictional utilities by the Rule. On rehearing we affirm most of the provisions set out in Order No. 888 for the *pro forma* tariff. We do make changes to conform the *pro forma* tariff to

changes adopted under other sections (for example, the definition of "eligible customer").

The rehearing petitions raised many questions about how particular aspects of the tariff will work. For the most part, these questions cannot be answered generically, but must be resolved on a case-by-case basis in the context of specific fact situations. However, the petitions brought to light issues that require clarifications and in some cases revisions to the tariff. The most significant of these involve discounting practices, provisions governing priority of service and curtailment, and the reciprocity provision.

Discounting practices. Originally, we provided different rules depending upon whether the transmission provider was offering a discount to itself or an affiliate or offering a discount to a non-affiliate. In response to the rehearing petitions, we are making three significant changes to the discounting requirements to better permit the ready identification of discriminatory discounting practices while also providing greater discount flexibility.

First, any discount offered on transmission services (including supporting ancillary services) by a transmission provider or requested by any customer must now be made only over the OASIS. With this change, all will have the same, timely access to discounted services. In making this change, we clarify that a transmission provider may limit its discounted service to particular time periods.

Second, once the provider and customer agree on a discount, the details of the discounted service -- the price,

points of receipt and delivery, and length of service -- must be immediately posted on the OASIS.

Third, we revise our Rule respecting what other transmission paths must be offered at a discount. Originally, in Order No. 888, we required that when a discount was offered over one path, the transmission provider would have to provide that discount over all other unconstrained paths on its system. We will no longer require this. Instead, the discount will be limited to those unconstrained paths that go to the same point(s) of delivery as the discounted service being provided on the transmission provider's system. The discount will extend for the same time period and must be offered to all transmission service customers.

Priority and Curtailment. We affirm the right of first refusal policy that reservation priority continues for firm service customers served under a contract of one year or more. We also affirm that curtailment must be made on a pro-rata basis and clarify that non-firm point-to-point service is subordinate to firm service. However, we clarify that the pro-rata curtailment requirement extends to only those transactions that alleviate the constraint.

Reciprocity. In Order No. 888 we conditioned the use of a public utility's open access service on the agreement that, in return, it is offered reciprocal service by non-public utilities that own or control transmission facilities. Such reciprocal service does not have to be through an open access tariff, i.e., a tariff available to all eligible customers, but may be limited to those public utilities from whom the non-public utility obtains open access service. We affirm the reciprocity

condition. In doing so, however, we make several clarifications.

First, a public utility is free to offer transmission service to a non-public utility without requiring reciprocal service in return. In other words, it may voluntarily waive the reciprocity condition. However, if it chooses to do so, transmission service must be provided through the pro forma tariff. Alternatively, bilateral agreements for transmission service provided by the public utility will not be permitted.

Second, we clarify that under the reciprocity condition a non-public utility must agree to offer the Transmission Provider any transmission service the non-public utility provides or is capable of providing on its system. This means that the non-public utility undertaking reciprocity must have an OASIS and must operate under the standards of conduct imposed under Order No. 889 unless it is granted a waiver by the Commission or, where appropriate, by a regional transmission group (RTG) of which it is a member. We also clarify that a non-public utility cannot avoid its responsibilities by **[30,181]** obtaining transmission service through other transmission customers. Further, the seller as well as the buyer in the chain of a transaction involving a non-public utility will have to comply with the reciprocity condition.

Third, we adhere to our decision not to treat generation and transmission (G&T) cooperatives and their member distribution cooperatives as a single unit. Thus, the reciprocity provision extends to the G&T Cooperative and not to its member distribution cooperatives.

Fourth, we clarify the "safe harbor" provision under which a non-public utility may get a Commission decision that its transmission tariff suffices to meet reciprocity. A non-public utility may limit the use of any reciprocity tariff that it voluntarily files at the Commission to those transmission providers from whom the non-public utility obtains open access service. A non-public utility also may satisfy reciprocity through bilateral agreements with a public utility. As a related matter, if a public utility believes a non-public utility is violating the reciprocity condition, it may file with the Commission a petition to terminate its service to the non-public utility.

Fifth, we clarify that non-public utilities may include stranded cost provisions in their reciprocity tariffs.

Sixth, the order on rehearing removes the term "interstate" from the reciprocity provisions. This is to make clear that reciprocity applies even to those who do not own or control interstate transmission facilities; *i.e.*, foreign utilities and those located in the ERCOT region of Texas.

As to local furnishing bonds held by some public utilities, we clarify that all costs associated with the loss of tax-exempt status of those bonds caused by providing open access transmission service are properly considered costs of providing that service. This includes costs of defeasing, redeeming, and refinancing those bonds.

Other Clarifications. In this order on rehearing we take the opportunity to clarify various other tariff provisions. Among these: Transmission providers do not have to take service under the open access tariff for transmitting power

purchased on behalf of their bundled retail customers. Also, the ability to reserve capacity to meet the reliability needs of a transmission provider's native load applies equally to present transmission and transmission that is built in the future.

Implementation

On rehearing, we make no substantive changes to the implementation provisions originally required under Order No. 888. For the most part, the implementation process has been completed. Utilities have made the requisite tariff and compliance filings and public and non-public utilities have, through other orders, been provided guidance as to obtaining waivers of Order No. 888 and Order No. 889 requirements.

We emphasize that we do not require the abrogation of existing contracts. Rather, the Rule requires only that transmission providers offer transmission under the open access tariff in addition to existing service obligations. Commitments made under existing contracts will continue. Of course, both transmission providers and their customers may seek to revise the terms and conditions of existing contracts by making the necessary filings, as appropriate, under Sections 205 or 206 of the Federal Power Act.

State and Federal Jurisdiction

On rehearing we reaffirm our decision that when transmission service is provided to serve retail customers apart from any contract for the retail sale of power, i.e., when it is provided on an unbundled basis, that transmission service is under our jurisdiction. In today's market, and increasingly

in the future as more states adopt retail wheeling programs, retail transactions are, and will be, broken down into products that are sold separately -- transmission and generation -- and sold by different entities. The exercise of our jurisdiction over the rates, terms and conditions of unbundled retail transmission will, therefore, become more important. We also recognize that states have jurisdiction over facilities used for local distribution.

On rehearing we also reaffirm the seven-factor test of Order No. 888 to distinguish transmission under our jurisdiction from state-jurisdictional local distribution. In doing so, we recognize that our test does not resolve all possible issues. There may be other factors that should be taken into account. The test, therefore, is designed for flexibility to include unique local characteristics and usages. To that end, we will continue to defer to state findings on these matters.

In addition, we clarify that states have the authority to determine the retail marketing areas of the electric utilities within their respective jurisdictions. We also recognize that states have the concomitant authority to determine the end user services these utilities provide.

Stranded Costs

On rehearing, we reaffirm our basic decisions surrounding the recovery of stranded costs. Utilities will be allowed the opportunity to seek to recover legitimate, prudent, and verifiable wholesale stranded costs. This opportunity is limited to costs associated with serving customers under wholesale requirements contracts executed on or before July

11, 1994 that do not contain explicit stranded cost provisions; and costs associated with serving retail-turned-wholesale customers.

We clarify that we will consider on a case-by-case basis whether to treat a contract extended or renegotiated without a stranded cost provision as an existing contract for stranded cost purposes.

In each case, the opportunity to seek stranded costs is limited to situations in which there is a direct nexus between the availability and use of a Commission-required transmission tariff and the stranding of the costs. The Rule does not allow the recovery of costs that do not arise from the new, accelerated availability of non-discriminatory transmission access.

The Commission also reaffirms its decision that stranded costs should be recovered from the customer that caused the costs to be incurred. The Commission is not requiring other remaining customers, or the utility, to shoulder a portion of its stranded costs that meet the requirements for recovery.

The Commission, as described in Order No. 888, will be the primary forum for addressing the recovery of stranded costs caused by retail-turned-wholesale customers. With respect to such cases, we have made several changes.

First, the Commission has reconsidered its decision respecting cases involving existing municipal utilities that annex retail customer service territories. Under Order No. 888, we found that in such cases the Commission should not

be the primary forum for determining stranded cost recovery. On rehearing we now find that such cases should fall within our province.

Second, we clarify that the opportunity for recovery of stranded costs associated with retail-turned-wholesale customers applies regardless of whether the customer or its new supplier is the one requesting and contracting for the transmission service. To this end, we have revised the definition of "wholesale stranded cost."

With respect to the recovery of stranded costs caused by unbundled retail wheeling, we affirm that the only circumstance in which we will entertain requests for these types of costs is when the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required. We clarify that if a state regulatory authority has in fact addressed such costs, regardless of whether it has allowed full recovery, partial recovery or no recovery, utilities may not apply to the Commission to recover stranded costs caused by the retail wheeling.

Other

In this section we resolve questions concerning our information reporting requirements, regional transmission groups, and the special situations posed by utilities in the Pacific Northwest and by federal power marketing and similar agencies. Here we make some minor clarifications but make no significant changes to Order No. 888.

We are not persuaded that the information reporting requirements need to be changed at this time. Finally, we reject arguments that would have us fix generically any particular rate methodology for providing open access transmission service under the *pro forma* tariff.

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[pp. 30,208 - 30,218]

[30,208]

The Commission's General Counsel Never Asserted, Or Even Suggested, That The Commission Does Not Have The Authority To Order Wheeling As A Remedy For Undue Discrimination

Union Electric spends several pages of its rehearing request asserting that the Commission's own General Counsel has acknowledged the limitations on the Commission's authority to order wheeling.[98] In particular, it points to a statement by a Commission OGC witness that "'if Congress intends for the Commission to be able to deal with transmission on its own motion and thereby go further than simply dealing with industry proposals,' Congress would need 'to include an affirmative statement somewhere in the Act that the Commission could require wheeling on its own motion.'"[99] This same statement was previously raised by EEI and previously addressed in Order No. 888. We do not

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[98]Union Electric at pp. 37-40.

[99]Union Electric at pp. 38-39.

disagree that this statement was made. However, it must be read in the context of the witness' entire testimony in which the witness stated *four* times the view that the case law supports the argument that the Commission has authority to order wheeling as a remedy for undue discrimination.[100] Indeed, contrary to Union Electric's assertion, the extensive legal analysis set forth by the Commission's witness supports the position relied upon in this proceeding.[101] Thus, viewed in

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[100]Hearings on H.R. 1301, H.R. 1543, and H.R. 2224 before the Subcommittee on Energy and Power of the House Committee on Energy and Commerce, 102d Cong., 1st Sess. (May 1,2 and June 26, 1991), Statement of Cynthia A. Marlette, Associate General Counsel, Federal Energy Regulatory Commission, Report No. 102-60 at p. 60 ("However, as discussed below, there are strong legal arguments that the Commission's obligation to protect against undue discrimination carries with it the authority to impose transmission requirements as a remedy for undue preference or discrimination." "As discussed below, although the case law in this area has been uncertain, in OGC's opinion there is a strong legal argument that the Commission can require transmission as a remedy for undue preference or undue discrimination."); at pp. 69-70 ("The weight of the limited case law, particularly the AGD opinion, supports authority to order wheeling as a remedy for undue discrimination where substantial evidence exists."); at p. 106 ("I believe that we have substantial authority under the existing case law to mandate access where necessary to remedy anticompetitive effects.").

[101]The statement quoted was preceded by a legal analysis of the Commission's authorities under then existing law, including section 206, and a statement that an examination of the Commission's full authorities might further open up the industry. Further, it was made in the context of case-by-case industry

the context of the witness' entire testimony, Union Electric's arguments to the contrary are unavailing. Moreover, nowhere did the witness ever suggest, as asserted by Union Electric, that FPA sections 205 and 206 could only be used "to eliminate unduly discriminatory terms in a wheeling arrangement voluntarily filed with the Commission."[102]

The Commission Has The Authority To Order Public Utilities To Make Rate Filings In This Proceeding

We reject Union Electric's argument that our requirement that Group 2 Public Utilities make section 205 filings is contrary to the voluntary filing scheme inherent in section 205. It is true that the Commission ordinarily cannot require a utility to make a section 205 filing. However, in this situation the section 205 filing was required as a remedy under section 206 of the FPA to establish rates for non-discriminatory open access transmission. Acting pursuant to section 206 of the FPA, we found that undue discrimination exists in the wholesale transmission of electric power and ordered the filing of non-discriminatory open access transmission tariffs to remedy this discrimination. Section 206 further requires that upon such a finding the Commission "shall determine the just and reasonable rate, charge, classification, rule, regulation, **[30,209]** practice, or contract to be thereafter observed and in force. . . ." Thus, we had the

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proposals and the Commission's inability to require case-by-case wheeling on its own motion. It did not address section 206 authority to remedy undue discrimination.

[102]Union Electric at p. 39. We note that Union Electric did not cite to any page or particular language to support its assertion.

authority to set the rates that would be observed and in force following the effectiveness of open access transmission and initially proposed to set rates for each public utility. However, rather than take this intrusive approach, which necessarily would have required a number of generic assumptions and resulted in less than public utility-specific rates, upon issuance of the Final Rule, we chose to permit these public utilities to make section 205 filings to propose their own rates for the services provided in the *pro forma* tariff.

The Commission's Prior Failure To Order Wheeling As A Remedy For Undue Discrimination Is Not Dispositive

After discussing several cases that it asserts address the Commission's authority to remedy undue discrimination, Carolina P&L declares that "[p]erhaps the strongest evidence that the Commission lacks the power to compel wheeling under FPA section 206 is the fact that the Commission has never previously exercised this alleged power, despite numerous opportunities to do so."[103] However, the court in AGD succinctly dismissed a similar argument:

> It is finally argued that the Commission's not having imposed any requirements like those of Order No. 436 in the period from enactment in 1938 until the present demonstrates the lack of any power to do so. . . . But as our introductory review of the economic background sought to illustrate, the Commission here deals with conditions that are

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[103]Carolina P&L at pp. 35-36.

> altogether new. Thus no inference may be drawn from prior non-use.[104]

Undue Discrimination/Anticompetitive Effects[105]

A number of utilities and state commissions argue that the Commission lacks evidence to support a finding of undue discrimination.[106]

VA Com argues that the Commission failed to make a legally supportable finding of industry-wide undue discrimination: "FERC apparently drew a conclusion that there was undue discrimination in the NOPR without support and later accepted customers' allegations, without further inquiry, and relied on them in making its finding of industry-wide undue discrimination." (VA Com at pp. 2-3).

PA Com and Carolina P&L assert that allegations of undue discrimination do not form a sufficient basis to compel a generic rulemaking. Not coming forward with specific

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[104]824 F.2d at 1001. In this regard, we acknowledge that our view of what constitutes undue discrimination has evolved significantly in light of the dramatic economic changes in the industry, as described briefly above and more fully in Order No. 888.

[105]*FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,682-84; *mimeo* at pp. 136-42.

[106]*E.g.*, El Paso, Union Electric, Carolina P&L, VA Com, FL Com, PA Com.

accusations and the identity of specific accusers, PA Com asserts, is unconstitutional as a deprivation of due process.

With regard to specific allegations of undue discrimination, SoCal Edison argues that the Commission inappropriately relied upon allegations involving SoCal Edison as evidence of undue discrimination. SoCal Edison asks that the Commission declare that it is not making a factual determination as to any particular allegation especially since prior to 1994 the Commission defined discrimination differently. Dalton similarly argues that the Commission has no basis for finding that Georgia Power Company is engaged in unlawful undue discrimination as to new or roll-over transmission services in the operation of the Integrated Transmission System in Georgia (ITS) under the ITS agreement. Moreover, Dalton argues, even if it is found that GPC acted in unduly discriminatory manner, it is not practical or lawful to order open access tariff for new and roll-over services.

Finally, Carolina P&L argues that the comparability standard does not eliminate the "requirement" that parties must be similarly situated before discrimination is present, and that the Commission has not provided factual support for its implicit finding that public utilities and their native load customers are similarly **[30,210]** situated to third parties. It cites *City of Vernon v. FERC*, 845 F.2d 1042 at 1045-46 (D.C. Cir. 1988), in support.

Commission Conclusion

As an initial matter, the Commission grants SoCal Edison's request for clarification that in Order No. 888 we

did not make a factual determination as to any particular allegation of past discrimination described in the Final Rule.[107] However, we reject arguments that the Commission cannot rely in part on the array of allegations and circumstances raised by customers in individual cases over the years and brought forth in response to the NOPR. The specific allegations are illustrative. However, they present examples of the types of discriminatory incentives and behavior inherent in ownership of monopoly transmission facilities, and also present credible examples of the types of discriminatory behavior in which public utilities could engage in the future. We also reject arguments that customers and the Commission must litigate and make specific findings of discrimination against each public utility before we can take any action to preclude discriminatory behavior that will harm competition and, ultimately, electricity consumers. This is particularly true where the discriminatory behavior clearly is in the economic self-interest of a monopoly transmission owner facing the markedly increased competitive pressures that are driving today's electric utility industry. As we recognized in Order No. 888,

> [t]he inherent characteristics of monopolists make it inevitable that they will act in their own self-interest to the detriment of others by

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[107]In response to PA Com's and Carolina P&L's assertions that not coming forward with specific accusations and identities of specific accusers is unconstitutional and a deprivation of due process, we emphasize that the Commission has not denied due process to anyone. The Final Rule does not, nor is it intended to, make specific findings as to any particular utility or any particular allegation raised.

> refusing transmission and/or providing inferior transmission to competitors in the bulk power markets to favor their own generation, and it is our duty to eradicate unduly discriminatory practices. As the AGD court stated: "Agencies do not need to conduct experiments in order to rely on the prediction that an unsupported stone will fall."[108]

We believe that the same general discriminatory circumstances that faced us when we required open access transportation in the natural gas industry[109] are also before us today in the electric industry. First, it is uncontested that market power continues to exist in the ownership and operation of the monopoly-owned facilities that comprise the nation's interstate transmission grid. Second, utilities, as a general matter, did not in the past offer comparable transmission services to competitors or to customers. Open access services simply were not made available by utilities until the late 1980s when the Commission began to impose open access as a condition of approval of market-based rates and utility mergers in order to mitigate market power and remedy anticompetitive effects. Rather, the vast majority of utilities historically have declined to transport electric energy that would compete with their own sales or have offered access that is inferior to what they use for their own sales. Third, discrimination in transmission services, when viewed in light of utilities' own uses of their transmission systems

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[108] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 331,682; *mimeo* at pp. 136-37.

[109] *See AGD*, 824 F.2d at 999-1000.

compared to what they offer third parties, has denied and will continue to deny customers access to electricity at the lowest reasonable rates. The entities on rehearing have raised nothing to persuade us that it is in the interests of consumers to maintain the self-evident incentives for transmission owners to exercise their monopoly power over transmission to discriminate in favor of their own generation sales -- incentives that will only increase in the future as competitive pressures continue to escalate.

The Commission addressed the same argument as that being made by Carolina P&L, that the Commission has not made the requisite finding that third-party transmission customers are similarly situated to public utilities and their native load customers, in 1994 in the *NEPOOL* **[30,211]** and *AEP* cases.[110] In these cases, we recognized that the traditional focus of our undue discrimination analysis had been whether factual differences justify different rates, terms and conditions for similarly situated customers, but concluded that due to changing conditions in the electric utility industry, it was necessary to reevaluate our traditional analysis. As we stated in *NEPOOL*, the focal point of undue discrimination claims has shifted from claims of undue discrimination in rates and services which the utility offers different customers to claims of undue discrimination in rates and services which the utility offers when compared to its own use of the transmission

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[110]*New England Power Pool*, 67 FERC ¶61,402 (1994) (*NEPOOL*); *American Electric Power Service Corporation*, 64 FERC ¶61,279 (1993), *reh'g granted*, 67 FERC ¶61,168, *clarified*, 67 FERC¶61,317 (1994) (*AEP*).

system.[111] "In this context, framing the analysis in terms of how a public utility treats similarly situated customers is not applicable or instructive."[112] The Commission concluded that it therefore must reexamine its application of the standard for undue discrimination claims under sections 205 and 206 of the FPA. The Commission further elaborated on its re-examination of undue discrimination in AEP. The Commission cited its NEPOOL discussion and set for hearing the different uses that AEP made of its transmission system and whether there were any operational differences between any particular use that AEP made of the system and the use third parties might need, and, in particular, the degree of flexibility AEP accorded itself in using its transmission system for different purposes. The Commission subsequently set the same issue for hearing in several other cases.[113] In the NOPR, however, the Commission concluded that based on what it had learned in the ongoing cases, it would address this issue generically in this rulemaking. We announced in the NOPR our belief that all utilities use their own systems in two basic ways: to provide themselves point-to-point transmission service that supports coordination sales, and to provide themselves network transmission service that supports the economic dispatch of their own generation units and purchased power resources (integrating their resources to meet their internal load). Third parties may need one or both

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[111] 67 FERC ¶61,042 at p. 61,132.

[112] *Id.*

[113] *Commonwealth Edison Co.*, 70 FERC ¶61,204 (1995); *Wisconsin Electric Power Co.*, 70 FERC ¶61,074 (1995); and *Wisconsin Public Service Corp.*, 70 FERC ¶61,075 (1995).

of these basic uses in order to obtain competitively priced generation or to have the opportunity to be competitive sellers of power, and the Commission proposed that all public utilities must offer both services on a non-discriminatory open access basis.[114]

We affirmed this determination in the Final Rule. We concluded that a public utility must offer transmission services that it is reasonably capable of providing, not just those services that it is currently providing to itself or others. Because a public utility that is reasonably capable of providing transmission services may provide itself such services at any time it finds those services desirable, it is irrelevant that it may not be using or providing that service today.[115] Thus, based on the analysis in this record, the Commission has determined that undue discrimination in the provision of transmission services in today's industry does not turn on whether utilities and their native load customers are similarly situated to third parties, but instead turns on whether the utility is providing comparable service, that is, service that it is reasonably capable of providing to other users of the interstate transmission system.

In short, the Commission is not bound to a static application of its undue discrimination analysis under the FPA and, indeed, has a public interest responsibility to reexamine undue discrimination in light of changed circumstances in the

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[114]*FERC Statutes and Regulations* ¶32,524 at p. 33,079.

[115]*FERC Statutes and Regulations* at p. 31,690; *mimeo* at p. 160.

industry.[116] That is what we began in NEPOOL and AEP and have completed in this rulemaking. The traditional "similarly **[30,212]** situated" test, while applicable to discrimination among third-party customers, simply is not applicable when analyzing discrimination between third-party transmission customers and transmission owners. Under Carolina P&L's theory, presumably the only customers that could be shown to be similarly situated would be those who own monopoly transmission facilities and have native load (i.e., captive) customers. This would preserve customer captivity, perpetuate monopoly power and profits, and deny the lowest reasonable rates to consumers. We therefore reject Carolina P&L's arguments.

Moreover, the fact that public utilities and their native load customers have been treated differently from third-party transmission customers because they are not among those traditionally considered to be "similarly situated" is precisely the target at which Order No. 888 takes aim. Historically, competitively-priced power was not broadly available to wholesale customers because the industry was dominated by

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[116]There is no "requirement" in the FPA that the Commission apply a "similarly situated" test. Carolina P&L's reliance on City of Vernon is misplaced. That case involved a claim of discrimination in the type of service offered to a wholesale customer versus that offered to retail customers, and the Commission's application of the "similarly situated" and "same service" test. Contrary to Carolina P&L's implication, the case does not hold that the Commission is bound to apply a "similarly situated" test in analyzing undue discrimination claims under the FPA.

vertically integrated IOUs[117] and, to the extent cheaper generation alternatives were available in the marketplace, transmission owners either took the cheaper power for their own uses or purchased and re-sold it at a profit.[118] Prior to EPAct, most power customers took power from the vertically integrated utilities that provided their transmission service. Transmission-only transactions played a secondary role in bulk power markets, facilitating certain economy transactions and coordination and pooling arrangements that improved utility operational efficiencies, largely as a complement to bundled bulk power transactions. Given the predominantly vertically-integrated industry and efficiencies that could be gained through encouragement of coordination and pooling transactions, the Commission was willing to accept utility practices that provided third parties with transmission services that were distinctly inferior to the utility's own uses of the transmission system.

In the future, however, unbundled transmission service will be the centerpiece of a freely traded commodity market in electricity, in which all wholesale customers can shop for power. In a market characterized by a significant increase in

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[117]I.e., investor-owned utilities that owned generation, transmission and distribution facilities and most of whom had captive customers.

[118]Very simply, the transmission owner was able to prevent third parties from achieving the maximum savings possible in the generation market by withholding or delaying transmission service. Alternatively, the transmission owner could purchase the power and resell it to the third party at a rate that reflected a mark-up from the first power sale.

non-vertically integrated power suppliers and competitively priced power that is now meaningfully available, it is no longer in the interest of wholesale customers for the Commission to tolerate the types of practices that were previously accepted. We cannot allow what have become unduly discriminatory practices to erect barriers between customers and the rapidly emerging competitive electricity marketplace. Accordingly, a primary goal of Order No. 888 is to provide that in the future transmission providers and third-party transmission customers are "similarly situated" in the quality of transmission service available to them.

C. Comparability

1. Eligibility to Receive Non-discriminatory Open Access Transmission

In the Final Rule, the Commission modified the definition of "eligible customer" and, among other things, clarified that any entity engaged in wholesale purchases or sales of electric energy, not just those "generating" electric power, is eligible.[119] The Commission also clarified that entities that would violate section 212(h) of the FPA (prohibition on Commission-mandated wheeling directly to an ultimate consumer and sham wholesale transactions) are not eligible. Further, the Commission clarified that foreign entities that otherwise meet the eligibility criteria may obtain transmission services. The **[30,213]** Commission also provided for service to retail customers in circumstances that

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[119]*FERC Statutes and Reuglations, Regulations Preambles January 1991-June 1996* at pp. 31,688-90; *mimeo* at pp. 154-58.

do not violate FPA section 212(h). Persons that would be eligible section 211 applicants also would be eligible under the open access tariff.

a. Unbundled Retail Transmission and "Sham Wholesale Transactions"

Rehearing Requests

Several entities assert that there is an inconsistency between tariff language and preamble language and argue that section 1.11 of the tariff should be made consistent with the preamble to ensure that, absent a state-approved program, retail wheeling is not available under the tariff, no matter which party requests service.[120] They maintain that the limitation in section 1.11 that the transmission provider only must provide retail transmission service voluntarily or under a state-approved program appears to apply only when a retail customer is the purchaser, not when the transmission purchaser is an electric utility. They suggest the following language to remedy the problem: "however, such entity is not eligible for transmission service that would be prohibited by Sections 212(h)(1) and/or 212(h)(2) of the Federal Power Act, unless such service is provided pursuant to a state retail access program or pursuant to a voluntary offer of unbundled retail transmission service by the Transmission Provider." (PSE&G at p. 22; Carolina P&L at pp. 8-9).

Detroit Edison argues that the Commission should modify the definition to exclude any reference to transmission

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[120] *E.g.*, SoCal Edison, PSE&G, Carolina P&L.

service provided to retail customers so as to avoid confusion and possible forum shopping. At the least, Detroit Edison argues, the Commission should modify the language to state that transmission service is available to an ultimate consumer to the extent, and only to the extent, that the service is authorized by a lawful state retail access program or pursuant to a voluntary offer of unbundled retail transmission service by the transmission provider.

NYSEG asserts that the Commission did not apply the section 212(h) limitation to service to retail customers under the tariff. NYSEG requests that the Commission clarify that it will not require retail wheeling beyond the scope of state-mandated retail access programs or beyond the terms of a transmission provider's voluntary offer of retail wheeling service.

Oklahoma G&E asks the Commission to clarify that the term eligible customer differentiates between a customer eligible to receive transmission service and a customer whose transaction is a sham or would result in mandatory retail wheeling and would therefore be prohibited by section 212(h).

NYSEG further asserts that the right of first refusal provision would permit a retail customer receiving wheeling service to continue to take that service upon expiration of its contract, which could require the transmission provider, in violation of section 212(h), to continue retail wheeling beyond the scope of its voluntary offer of service or beyond the scope of a state-mandated retail access program.

SoCal Edison argues that the Commission cannot compel a utility to supply retail transmission service if the

utility challenges the authority of the state to require retail wheeling and section 1.11 should be revised to reflect this.

IL Com declares that it "does not recognize FERC's claim of jurisdiction over retail transmission service provided directly to a retail customer and disputes that unbundled retail wheeling directly to a retail customer is a service provided in interstate commerce." (IL Com at 35). Thus, "if FERC's proposed 'deference' to states is to be given any effect, states must be allowed to determine whether the retail transmission component of the retail wheeling program will be provided pursuant to the utility's existing filed wholesale tariff or whether the retail transmission will be provided pursuant to a 'separate retail transmission tariff' that is different from the wholesale tariff." (IL Com at 36). IL Com concludes that it is inappropriate (and illegal if FERC is overturned on its retail transmission jurisdiction assertion) to include retail customers taking final delivery of unbundled power for their own end uses under retail wheeling programs as eligible customers.

[30,214]

PA Com argues that it is relevant whether a customer is receiving retail or wholesale service and redefining transmission and local distribution service does not automatically convey jurisdiction to the Commission.

CCEM asks that the Commission clarify that a retail customer eligible to seek transmission service should be able to seek transmission service not only from the transmission provider, but from any other transmission provider. CCEM also asks that the Commission add the word "ultimate" before the word transmission provider in section 1.11 of the tariff.

EEI asks the Commission to "clarify that the transmission service provider should be allowed to supplement the terms and conditions of the *pro forma* tariff with additional provisions that specifically relate to the totality of the transmission service being provided, including the use of distribution facilities and any other transmission facilities not currently included in wholesale rates." (EEI at p. 24 (emphasis in original)).[121]

Union Electric argues that a literal reading of the eligibility definition could require retail wheeling by utilities in states other than those required to participate in a particular retail wheeling program.

Commission Conclusion

The Commission agrees with those entities that argue that section 1.11 of the pro forma tariff does not explicitly prohibit "sham wholesale transactions" that could currently be arranged under the tariff by a utility applying for service and designating the retail customer as a point of delivery. We therefore have modified section 1.11 to clarify that, with respect to service that we are prohibited from ordering by section 212(h) of the FPA (whether direct retail wheeling or "sham" wholesale wheeling), otherwise eligible entities may obtain such service under the tariff only if it is pursuant to a state requirement that such service be provided or pursuant to a voluntary offer of such service. We also have modified the language to clarify that eligibility for unbundled direct retail service required by a state applies only to service from

[121]See also *CSW Operating Companies*.

transmission providers that the state orders to provide the service. The modified language states:

> Eligible Customer: (i) Any electric utility (including the Transmission Provider and any power marketer), Federal power marketing agency, or any person generating electric energy for sale for resale is an eligible customer under the tariff. Electric energy sold or produced by such entity may be electric energy produced in the United States, Canada, or Mexico. However, with respect to transmission service that the Commission is prohibited from ordering by Section 212(h) of the Federal Power Act, such entity is eligible only if the service is provided pursuant to a state requirement that the Transmission Provider offer the unbundled transmission service, or pursuant to a voluntary offer of such service by the Transmission Provider. (ii) Any retail customer taking unbundled transmission service pursuant to a state requirement that the Transmission Provider offer the transmission service, or pursuant to a voluntary offer of such service by the Transmission Provider, is an eligible customer under the tariff.

Regarding SoCal Edison's argument, the Commission stated in the Final Rule:

> Moreover, we are mindful of the fact that we are precluded under section 212(h) from

> ordering or conditioning an order on a requirement to provide wheeling directly to an ultimate consumer or sham wholesale wheeling. We therefore clarify that our decision to eliminate the wholesale customer eligibility requirement does not constitute a requirement that a utility provide retail transmission service. Rather, we make clear that if a utility chooses, or a state lawfully requires, unbundled retail transmission service, such service should occur under this tariff unless we specifically approve other terms.[122]

Therefore, the Commission is not compelling a utility to provide unbundled retail transmission service.[123] Rather, the Commission **[30,215]** requires that should such service be provided, either pursuant to state mandate or voluntarily, it must be provided pursuant to the pro forma tariff unless the Commission approves alternative terms and conditions.

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[122]*FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,689-90; *mimeo* at p. 158.

[123]We also disagree with NYSEG's assertion that the right of first refusal provision would permit a retail customer receiving wheeling service to continue to receive service after the expiration of its contract and could require the transmission provider to continue wheeling beyond the scope of its voluntary offer of service or beyond the scope of a state-mandated retail access program. Section 212(h) of the FPA would override any provision, including the right of first refusal provision, that may be included in the pro forma tariff.

However, in light of CCEM's request that we clarify that a retail customer eligible to seek transmission service under the tariff should be able to seek service not only from the transmission provider, but also from any other transmission provider, and in light of Union Electric's concerns regarding retail service eligibility, we believe certain clarifications of our jurisdiction and of the statements made in Order No. 888 are necessary. The statements cited above that were made in Order No. 888 and the eligible customer tariff definition in (ii) above refer to direct retail transmission, i.e., the transmission of electric energy "directly" to an ultimate consumer. The Commission is prohibited by section 212(h)(1) of the FPA from ordering this type of retail transmission and that is why customers are eligible for such transmission under the tariff only if the transmission is pursuant to a state order or is provided voluntarily. However, on its face, section 212(h) does not prohibit the Commission from ordering public utilities to provide "indirect" unbundled retail transmission in interstate commerce, i.e., the transmission necessary to transmit unbundled electric energy to a utility that ultimately will deliver the energy to a customer that is purchasing the unbundled energy at retail either pursuant to a state retail access order or pursuant to voluntary delivery by the local utility.

We clarify that we believe we have the jurisdiction under the FPA to order indirect retail transmission to an ultimate consumer and that if the Commission under sections 205, 206 or 211 of the FPA orders such transmission, entities that otherwise qualify as eligible customers under the tariff will take transmission service for such indirect retail wheeling pursuant to the *pro forma* tariff. We note that the Commission may order such transmission on a case-by-case basis or may

determine to do so generically in the future. We expect public utilities to provide such indirect retail access under the *pro forma* tariff and, if they do not, we will not hesitate to order them to do so.

In response to IL Com's argument that it does not recognize this Commission's claim of jurisdiction over the rates, terms and conditions of unbundled retail transmission that is provided directly to an ultimate consumer, the Commission reaffirms its legal conclusion set forth in the Final Rule.[124] As to its claim that we should give deference to the state as to whether such service could be taken under the wholesale tariff or a separate retail tariff on file with the Commission, we reaffirm our conclusion to address this on a case-by-case basis. Since the Final Rule issued, the Commission has addressed this in several orders. In New England Power Company, the Commission stated:[125]

> As we explained in the Open Access Rule and in the New Hampshire Interim Order, we generally expect retail transmission customers to take service under the same Commission tariff that applies to wholesale customers.

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[124] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,780 and appendix G (at pp. 31,966-81); *mimeo* at p. 428 and appendix G.

[125] 75 FERC ¶61,356 at p. 62,141, *order on reh'g*, 77 FERC ¶61,135 (1996). In the order on rehearing, the Commission permitted a separate retail tariff to remain in effect for the duration of the retail electric pilot programs established in Massachusetts by Massachusetts Electric Company.

> While we generally will defer to state requests for a separate retail tariff to accommodate the design and special needs of a state retail access program, the Massachusetts Commission has made no such request in this case.[15]

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[15] See Open Access Rule, *FERC Statutes and Regulations*, at p. 31,784; *New Hampshire Interim Order*, 75 FERC at p. 61,687 & n.3 (both noting that such a separate retail tariff must **[30,216]** be consistent with the Commission's open access policies and comparability principles). . . .

Subsequently, in New England Power Company, 76 FERC ¶61,008 (1996), the Commission granted a limited waiver of the Open Access Rule requirements for the New Hampshire retail electric competition pilot project. Specifically, the Commission waived the requirement for individual service agreements, and the requirement for customer deposits. The Commission further announced that:

> other public utilities that provide unbundled retail service under a *pro forma* tariff do not need to apply to retail customers the tariff provisions regarding individual service agreements or customer deposits, unless a state retail program so requires.[126]

Concerning EEI's request for clarification, the Commission stated in the Final Rule:

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[126] 76 FERC at p. 61,024.

> all tariffs need not be "cookie-cutter" copies of the Final Rule tariff. Thus, under our new procedure, ultimately a tariff may go beyond the minimum elements in the Final Rule pro forma tariff or may account for regional, local, or system-specific factors. The tariffs that go into effect 60 days after publication of this Rule in the Federal Register will be identical to the Final Rule pro forma tariff; however, public utilities then will be free to file under section 205 to revise the tariffs, and customers will be free to pursue changes under section 206.[127]

Utilities are free to include customer-specific terms and conditions or terms and conditions limited to certain customers (*e.g.*, a distribution charge) in the customer's service agreement and/or the network customer's network operating agreement.

b. Transmission Providers Taking Service Under Their Tariff

Rehearing Requests

TAPS states that section 1.11 does not seem to require a transmission provider to take service for its purchases, but the preamble does (citing mimeo at 57, 191, 266 and

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[127] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,770 n. 514; *mimeo* at p. 399 n. 514.

regulatory text in section 35.28(c)(2)). It argues that transmission providers should be required to treat their own usage of the transmission system to serve retail customers under the network service provisions of the tariff. TAPS argues that this result could be achieved through an ISO or by requiring transmission providers to abide by all non-price terms of Parts I and III of the tariff. TAPS also argues that the rates charged network customers must be developed on the same basis as the transmission component of retail rates. It states that the transmission provider's purchases would then be made under Part III of the tariff to the extent they are made for serving retail customers. It further asserts that the Commission's authority and obligation to consider transmission owners' service to retail load in establishing wholesale transmission rates has been long established. At the least, TAPS argues that the Commission should require that a transmission provider take its wholesale purchases under some tariff.

Similarly, Coalition for Economic Competition asks the Commission to clarify that the requirement to use the *pro forma* tariff for wholesale purchases and to functionally unbundle wholesale purchases and sales does not apply to purchases made solely to serve retail customers on a bundled basis. It asserts that there is conflicting language in Order No. 888 (citing *mimeo* at p. 191) and Order No. 889 (citing *mimeo* at p. 12) and the *pro forma* tariff. Coalition for Economic Competition asserts that the Commission does not have jurisdiction over transmission that is part of a bundled retail sale.

Commission Conclusion

Several parties have noted on rehearing that there is conflicting language among the Final Rule, Order No. 889 and the *pro forma* tariff as to whether and to what extent the transmission provider must take service for "wholesale purchases" under its own tariff. As discussed below, we clarify that a transmission provider does not have to "take service" under its own tariff for the transmission of power **[30,217]** that is purchased on behalf of bundled retail customers.

In a situation in which a transmission provider purchases power on behalf of its retail native load customers, the Commission does not have jurisdiction over the transmission of the purchased power to the bundled retail customers insofar as the transmission takes place over such transmission provider's facilities,[128] and therefore the pro forma tariff does not have to be used for such transmission. Moreover, we recognize that purchases made collectively on behalf of native load[129] cannot necessarily be identified as

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[128]To the extent the transmission takes place on the interstate facilities of other public utilities, we would have jurisdiction over such transmission.

[129]Native load means "[t]he wholesale and retail power customers of the Transmission Provider on whose behalf the Transmission Provider, by statute, franchise, regulatory requirement, or contract, has undertaken an obligation to construct and operate the Transmission Provider's system to meet the reliable electric needs of such customers." Section 1.19 of the *pro forma* tariff.

going to any particular customer. However, the Commission does have jurisdiction over transmission service associated with sales to any person for resale, and such transmission must be taken under the transmission provider's pro forma tariff.[130]

Order No. 888, relying on the principle of comparability, established the terms and conditions for network service provided to network customers under the *pro forma* tariff. Network customers may include the transmission provider itself as well as any other entity receiving Network Integration Service. If the transmission provider purchases energy from another power supplier in order to make sales to its wholesale native load customers, it must take the transmission service necessary to transmit the power from its point(s) of receipt to its point(s) of delivery under the same terms and conditions as other Network Customers.[131] As we explained in *AES Power, Inc.*, network customers are entitled to make economy energy purchases from non-designated network resources at no additional charge on a basis

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[130]All transmission in interstate commerce by a public utility in conjunction with a sale for resale of electric energy is jurisdictional and must be taken under a FERC-jurisdictional tariff. The same is true for all unbundled transmission in interstate commerce to wholesale customers, as well as to unbundled retail customers.

[131]Under the Order No. 888 pro forma tariff, third-party wholesale customers have the ability to obtain the identical service the transmission provider provides itself when it engages in a sale of electric energy for resale. This may include network or point-to-point service.

comparable to the economy energy purchases made by the transmission provider on behalf of its bundled retail customer.[132] This applies to the transmission provider as a network transmission customer under its own tariff as well as to other network transmission customers that make economy energy purchases on behalf of their customers. Thus, insofar as all wholesale transmission customer usage is concerned, third-party network customers are treated the same as the transmission owner.

2. Service that Must be Provided by Transmission Provider

In the Final Rule, the Commission found that a public utility must offer transmission services that it is reasonably capable of providing, not just those services that it is currently providing to itself or others.[133] The Commission explained that because a public utility that is reasonably capable of providing transmission services may provide itself such services at any time it finds those services desirable, it is irrelevant that it may not be using or providing that service today. However, the Commission explained that if a customer seeks a customized service not offered in an open access tariff, a customer may, barring successful negotiation for such service, file a section 211 application.

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[132]69 FERC ¶61,145 at p. 62,300 (1994) (proposed order), 74 FERC ¶61,220 (1996) (final order).

[133]*FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,690; *mimeo* at p. 160.

Rehearing Requests

Cleveland requests that the Commission make explicit that comparability will be evaluated not only by reference to a transmission provider's wholesale services, but also by comparison to the terms, conditions, and prices applicable to **[30,218]** its retail services, whether bundled or unbundled. Cleveland asserts that this is needed so that TDUs are not at a competitive disadvantage in competing with the transmission provider for retail customers. It maintains that this is consistent with the Transmission Pricing Policy and established precedent.

Commission Conclusion

No clarification is necessary. In determining what transmission services a utility must offer for wholesale sales of electric energy in interstate commerce, the Final Rule explicitly states that "a public utility must offer transmission services that it is reasonably capable of providing, not just those services that it is currently providing to itself or others."[134] Further, the Final Rule requires that network service customers receive service comparable to the service provided to the transmission provider's native load. Because the Rule applies to retail transmission that is voluntarily offered or pursuant to a state retail access program, the requirements to offer services that the utility is reasonably capable of providing and services comparable to those

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[134] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996 at p. 31,690; mimeo at p. 160.*

provided to native load would also apply to retail service in these limited retail circumstances.

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[pp. 30,278 - 30,279]

[30,278]

3. Curtailment and Interruption Provisions[297]

a. Pro-Rata Curtailment Provisions

In the Final Rule, the Commission found that curtailment on a pro-rata basis is appropriate for curtailing transactions that substantially relieve a constraint.[298] The Commission explicitly allowed the transmission provider discretion to curtail the services, whether firm or non-firm, that substantially relieve the constraint.

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[297]In the Final Rule *pro forma* tariff, the Commission defines curtailment as: "A reduction in firm or non-firm transmission service in response to a transmission capacity shortage as a result of system reliability conditions." (pro forma tariff section 1.7). The *pro forma* tariff defines interruption as: "A reduction in non-firm service due to economic reasons pursuant to Section 14.7." (*pro forma* tariff section 1.15). The distinction between curtailment and interruption may have been blurred in Order No. 888 and this order attempts to clarify that distinction.

[298]*FERC Statutes and Regulations, Regulation Preambles January 1991-June 1996* at p. at 31,749; *mimeo* at pp. 335-36.

The Commission also indicated that it would consider granting deference to an alternative curtailment method to avoid hydro spill if such a regional practice is generally accepted and adhered to across the region.

The Commission further found that under network and point-to-point service, the transmission provider may propose a rate treatment (penalty provision) to apply in the event a customer fails to curtail service as required under the Final Rule pro forma tariff and indicated that such proposals will be evaluated on a case-by-case basis on compliance.

Rehearing Requests

PA Com asserts that pro rata curtailment fails to hold native load harmless to the extent practical as required by the FPA. PA Com points out that on January 19, 1994, PJM initiated pro-rata load shedding, in part to preserve economic transactions, leaving customers in Pennsylvania without power during a record cold spell.

VA Com argues that pro rata curtailment may harm native load customers and section 206 complaints are after the fact and of little assistance to native load. VA Com argues that curtailment priority (in order of curtailment) should be: non-firm, contract firm, and then native load, and that utilities should have flexibility to curtail on a pro-rata basis within classes, subject to state curtailment policy.

Several entities argue that provision must be made for preference in curtailment priorities obtained through settlement, through payment of good and valuable

consideration, or under existing transmission contracts.[299] Turlock argues that customers should be able to obtain a variation from the pro rata scheme if they can show that they have made either past or future investments to improve constrained facilities and that the quid pro quo for their investment is improved curtailment priority.

Allegheny asks the Commission to clarify that it did not intend to require public utilities to shed (through pro rata curtailment) native transmission load customers in order to preserve some portion of service to through system users of the grid. According to Allegheny, the FPA mandates that service reliability to franchise customers must be maintained and through-system users are not similarly situated to native transmission load customers and should not be treated the same in an emergency because through system customers can protect themselves, but native transmission load customers cannot. Allegheny adds that failure to maintain system reliability would violate section 211 of the FPA.

CCEM asserts that hard and fast priority rules are needed to prevent inconsistent rules from developing for different utilities, pools, or control areas.

Commission Conclusion

Assertions that the pro-rata curtailment provision in the tariff may harm native load customers are misplaced. The Commission clarified in the Final Rule that it was not requiring a pro-rata curtailment of all transactions at the time

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[299] *E.g.*, Santa Clara, Redding, TANC.

of a constraint, but rather curtailment of **[30,279]** those transactions, whether firm or non-firm, that effectively relieve the constraint.[300] The Commission also required that such curtailments be made on a non-discriminatory basis, including the transmission provider's own wholesale use of the system. The Commission further explained that the pro-rata curtailment provision was intended to apply to situations where multiple transactions could be curtailed to relieve a constraint. Of course, if curtailment of multiple transactions is necessary, non-firm service would be curtailed prior to firm service. However, the Commission established that, in emergencies, the transmission provider had the discretion to interrupt firm service under the tariff to ensure the reliability of its transmission system.

In terms of reliability, we believe that sufficient safeguards have been established to protect native load. In particular, the transmission provider is responsible for planning and maintaining sufficient transmission capacity to safely and reliably serve its native load. Order Nos. 888 and 889 permit the transmission provider to reserve, in its calculation of ATC, sufficient capacity to serve native load.

Allegations that a utility did not curtail on a non-discriminatory basis, but instead favored a certain class of customer or type of transaction should be filed in a section 206 complaint proceeding to be reviewed on a case-specific basis. While it is true that such complaints will be processed

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[300] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,749; *mimeo* at p. 335.

on an after-the-fact basis, it is only on a fact-specific basis that such complaints can be fully and adequately reviewed.

Additionally, tariff section 14.7 does in fact establish that for curtailment purposes, non-firm point-to-point transmission shall be subordinate to firm transmission service and non-firm service may also be interrupted for economic reasons. However, adopting curtailment schemes based solely on classes of service, as proposed by the VA Com, is inappropriate. Specifically, VA Com's proposal to curtail all non-firm transmission transactions prior to firm transactions could exacerbate an emergency situation. For example, a curtailment could be necessary due to a constraint affecting northbound transactions. However, curtailing all non-firm transactions, including southbound transactions (or counterflows), could worsen the situation. Accordingly, the Commission believes the approach established in the Final Rule of allowing non-discriminatory curtailments of the transaction(s) that effectively relieve(s) the constraint is appropriate.

In response to CCEM's concerns regarding the potential for inconsistent rules for different utilities, pools or control areas, the Commission explained in the Final Rule that any proposed deviations from the non-price terms and conditions of the pro forma tariff, such as regional practices, must be adequately supported by the utility proposing the change.

Finally, Order No. 888 did not abrogate existing contracts;[301] therefore, customers with unique curtailment priorities established by pre-existing contracts would not have these priorities eliminated for the term of the existing contract.

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[pp. 30,334 - 30,350]

[30,334]

I. Federal and State Jurisdiction: Transmission/Local Distribution

In the Final Rule, the Commission explained that after reviewing the extensive analysis of the FPA, legislative history, and case law contained in both the initial Stranded Cost NOPR and in the Open Access NOPR, and the comments received on that analysis, it reaffirmed its **[30,335]** assertion of jurisdiction over the transmission component of an unbundled interstate retail wheeling transaction.[451] The Commission also reaffirmed and clarified its determinations regarding the tests to be used to determine what constitute Commission-jurisdictional transmission facilities and what constitute state-jurisdictional local distribution facilities in

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[301] We note that in Order No. 888 we partially modified existing economy energy coordination agreements. *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,666; *mimeo* at p. 91.

[451] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,780-85; *mimeo* at pp. 427-42.

situations involving unbundled wholesale wheeling and unbundled retail wheeling.

The Commission also explained that where states unbundle retail sales, it will give deference to their determinations as to which facilities are transmission and which are local distribution, provided that the states, in making such determinations, apply the seven criteria discussed in the NOPR and reaffirmed by the Commission. In addition, the Commission clarified that there is an element of local distribution service in any unbundled retail transaction, and further clarified other aspects of its jurisdictional ruling to preserve state jurisdiction over matters that are of local concern and will remain subject to state jurisdiction if retail unbundling occurs.

The Commission reaffirmed its legal determination that if unbundled retail transmission in interstate commerce occurs voluntarily by a public utility or as a result of a state retail access program, this Commission has exclusive jurisdiction over the rates, terms, and conditions of such transmission. The Commission found compelling the fact that section 201 of the FPA, on its face, gives the Commission jurisdiction over transmission in interstate commerce (by public utilities) without qualification.

The Commission further explained that when a retail transaction is broken into two or more products that are sold separately, the jurisdictional lines change. In this situation, the Commission emphasized that the state clearly retains jurisdiction over the sale of the power, but the unbundled transmission service involves only the provision of

"transmission in interstate commerce" which, under the FPA, is exclusively within the jurisdiction of the Commission.

The Commission recognized that in asserting jurisdiction over unbundled retail transmission in interstate commerce by public utilities, it was in no way asserting jurisdiction to order retail transmission directly to an ultimate consumer. It explained that its assertion of jurisdiction is that if unbundled retail transmission in interstate commerce by a public utility occurs voluntarily or as a result of a state retail wheeling program, the Commission has exclusive jurisdiction over the rates, terms, and conditions of such transmission and public utilities offering such transmission must comply with the FPA by filing proposed rate schedules under section 205.

The Commission further clarified that nothing in its jurisdictional determination changes historical state franchise areas or interferes with state laws governing retail marketing areas of electric utilities. It explained that while its jurisdiction cannot affect whether and to whom a retail electric service territory (marketing area) is to be granted by the state, and whether such grant is exclusive or non-exclusive, neither can state jurisdiction affect this Commission's exclusive jurisdiction over transmission in interstate commerce by public utilities.

The Commission also adopted a new section 35.27(b) as follows:

> Nothing in this part (i) shall be construed as preempting or affecting any jurisdiction a state commission or other state authority may have under applicable state and federal law, or (ii)

> limits the authority of a state commission in accordance with state and federal law to establish (a) competitive procedures for the acquisition of electric energy, including demand-side management, purchased at wholesale, or (b) non- discriminatory fees for the distribution of such electric energy to retail consumers for purposes established in accordance with state law.

With respect to the Commission's adoption of the Open Access NOPR's functional/technical tests for determining what facilities are Commission-jurisdictional facilities used for transmission in interstate commerce and what facilities **[31,336]** are state-jurisdictional local distribution facilities, the Commission concluded that it could not divine a bright line for unbundled retail transmission by the public utility that previously provided bundled retail service to the end user. The Commission added that the limited case law, including *Connecticut Light & Power Company v. FPC (CL&P)* and *Federal Power Commission v. Southern California Edison Company* (the *Colton* case),[452] supports a case-by-case determination.[453] Accordingly, the

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[452]324 U.S. 515 (1945) (*CL&P*); 376 U.S. 205 (1964) (*Colton*).

[453]The Commission included a detailed legal analysis in Appendix G to Order No. 888. The Commission explained that it was particularly persuaded by the Supreme Court's statement that whether facilities are used in local distribution is a question of fact to be decided by the Commission as an original matter. *See CL&P*, 324 U.S. at 534-35).

Commission stated that its technical test, with its seven indicators, will permit reasoned factual determinations in individual cases.

The Commission made two clarifications regarding local distribution in the context of retail wheeling. First, it explained that even if its technical test for local distribution facilities were to identify no local distribution facilities for a specific transaction, states have authority over the service of delivering electric energy to end users. Second, the Commission explained that through their jurisdiction over retail delivery services, states have authority not only to assess retail stranded costs but also to assess charges for so-called stranded benefits, such as low-income assistance and demand-side management.

Thus, under this interpretation of state/federal jurisdiction, the Commission explained, customers have no incentive to structure a purchase so as to avoid using identifiable local distribution facilities in order to bypass state jurisdiction and thus avoid being assessed charges for stranded costs and benefits.

The Commission further determined that it is appropriate to provide deference to state commission recommendations regarding certain transmission/local distribution matters that arise when retail wheeling occurs.

In instances of unbundled retail wheeling that occurs as a result of a state retail access program, the Commission indicated that it will defer to recommendations by state regulatory authorities concerning where to draw the jurisdictional line under the Commission's technical test for

local distribution facilities, and how to allocate costs for such facilities to be included in rates, provided that such recommendations are consistent with the essential elements of the Final Rule.[454] Moreover, the Commission indicated that it will consider jurisdictional recommendations by states that take into account other technical factors that the state believes are appropriate in light of historical uses of particular facilities.

As a means of facilitating jurisdictional line-drawing, the Commission stated that it will entertain proposals by public utilities, filed under section 205 of the FPA, containing classifications and/or cost allocations for transmission and local distribution facilities. However, the Commission explained that, as a prerequisite to filing transmission/local distribution facility classifications and/or cost allocations with the Commission, utilities must consult with their state regulatory authorities. If the utility's classifications and/or cost allocations are supported by the state regulatory authorities and are consistent with the principles established in the Final Rule, the Commission indicated that it will defer to such classifications and/or cost allocations.

Furthermore, the Commission stated that deference to state commissions with regard to rates, terms, and conditions may be appropriate in some circumstances. The Commission

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[454]In order to give such deference, the Commission noted its expectation that state regulators will specifically evaluate the seven indicators and any other relevant facts and make recommendations consistent with the essential elements of the Rule.

explained that when unbundled retail wheeling in interstate commerce occurs, the transaction has two components for jurisdictional purposes -- a transmission component and a local distribution component. It again emphasized that the Commission has jurisdiction over facilities used for the transmission component of the transaction, and the state has jurisdiction over facilities used for the local distribution component. Thus, the Commission stated, **[30,337]** the rates, terms and conditions of unbundled retail transmission by a public utility must be filed at the Commission. However, the Commission added, if the unbundled retail wheeling occurs as part of a state retail access program, it may be appropriate to have a separate retail transmission tariff[455] to accommodate the design and special needs of such programs. In such situations, the Commission indicated that it will defer to state requests for variations from the FERC wholesale tariff to meet these local concerns, so long as the separate retail tariff is consistent with the Commission's open access policies and comparability principles reflected in the tariff prescribed by the Final Rule. In addition, the Commission indicated that the rates must be consistent with its Transmission Pricing Policy Statement, and the guidance set forth in Order No. 888 concerning ancillary services.[456]

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[455]The Commission noted that such a tariff could be different from the tariff that applies to wholesale customers, but that such tariff would still be filed with the Commission under FPA section 205.

[456]In applying the principles of the Final Rule to retail transmission tariffs, the Commission emphasized that it clearly cannot order retail wheeling directly to an ultimate consumer. (citing FPA section 212(h)).

The Commission also expressed concern, just as it did with buy-sell arrangements in the gas industry, that buy-sell arrangements can be used by parties to obfuscate the true transactions taking place and thereby allow parties to circumvent Commission regulation of transmission in interstate commerce. Thus, the Commission reaffirmed its conclusion that it has jurisdiction over the interstate transmission component of transactions in which an end user arranges for the purchase of generation from a third-party. Moreover, the Commission indicated that it will address these transactions on a case-by-case basis.

Rehearing Requests

Oppose Commission Assertion of Jurisdiction Over Unbundled Retail Transmission

Several state commissions indicate that, recognizing that the case law is not dispositive concerning the question of unbundled retail transmission services (either because the cases do not involve the transmission of power to retail customers or "fence off" local distribution from federal regulation), at least one court (*Wisconsin-Michigan Power Company v. FPC*, 197 F.2d 472 (7th Cir. 1952), *cert. denied*, 345 U.S. 934 (1953)) explicitly applied the wholesale/retail distinction to distinguish transmission and local distribution services.[457] Thus, they argue, the Commission should apply the wholesale versus retail analysis to the question of unbundled retail transmission.

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[457] *E.g.*, NARUC, WI Com, WY Com.

IL Com asserts that retail transmission by a public utility directly to an end user has always (even before the FPA was enacted) been subject to regulation by the states. It contends that no change in law has occurred which justifies the Commission's claim of expanded jurisdiction. Moreover, it disagrees with the Commission's conclusion that the unbundled delivery by the previous public utility generation supplier directly to an end user is in interstate commerce. It argues that the FPA was never intended to disturb the jurisdiction of state regulators that existed prior to its passage and that retail transmission of electric energy by a public utility to an end user was under state jurisdiction before the Attleboro decision and has remained under state jurisdiction in the over sixty years following Attleboro. Even after unbundling, according to IL Com, transmission to a retail customer still involves a retail sale of transmission.

NARUC and VA Com assert that the legislative history provides little support for the Commission's conclusion that the act of unbundling generation from delivery serves to shift jurisdiction from a state commission to the Commission. If anything, they contend, the jurisdictional structure of the FPA is predicated on the distinction between retail and wholesale transactions, not bundled and unbundled services. They assert that the Commission should conclude that the rates, terms and conditions of service for delivery of power by a utility to an end-use customer are subject to the jurisdiction of the state commission regulating the utility, regardless of the identity of the party generating **[31,338]** or reselling the power or the facilities used to transport the power.

NARUC asserts that the Commission did not address a point raised in NARUC's reply comments as to how the removal of generation serves to unbundle the retail delivery function into separate transmission and distribution services. It maintains that the Commission simply assumes that a resulting transmission transaction is created when power is sold to a retail consumer by someone other than the utility delivering the power.[458]

MI & NH Coms ask the Commission to vacate those portions of the Rule that find that the Commission has jurisdiction over the transmission component of an unbundled retail sale in a local retail wheeling transaction. They assert that the Commission should confine its activity to wholesale transactions or those interstate transactions that do not implicate matters of local concern. They argue that the dual federal/state regulatory scheme establishes that Congress' intent is that state regulation of retail wheeling is not preempted by federal law as established in FPA section 201. They oppose unnecessary federal intrusion into local matters under a one-size-fits-all approach and assert that the retail wheeling initiatives in New Hampshire and Michigan are tailored to the unique utility environment in each state.

Central Illinois Light argues that unbundling of retail electric service does not change the states' longstanding jurisdiction over retail electric service and local distribution,

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[458] *See also* IA Com (use of a utility's transmission system to serve its own retail customers is a bundled part of the retail sale transaction, which supports a simpler jurisdictional test holding that a movement of power by the last utility in any chain of delivery to a retail customer is a distribution transaction).

even when that service involves the use of transmission in interstate commerce. It asserts that 201(b)(1) ("transmission of electric energy in interstate commerce") cannot be read in a vacuum.

MN DPS & MN Com and OH Com assert that the Commission should have no role in the regulation of retail services, be they bundled or unbundled. They argue that, in refusing to grant the Commission authority over retail wheeling, Congress left jurisdiction over retail electric service to the states. They conclude that the Final Rule contains insufficient legal and/or policy justification for the Commission's assertion of jurisdiction over unbundled retail transmission services.

MN DPS & MN Com assert: "FERC bases its usurpation of state authority over retail transmission rates on its claim that balkanization would occur without the assertion of FERC authority. Therefore, the parties are entitled to rehearing so that this essential issue can be further analyzed." (MN DPS & MN Com at pp. 1-3).

FL Com argues that the Commission has not justified why the act of unbundling prices expands the Commission's jurisdiction into retail marketing areas. It argues that Section 212(g) of the FPA has the effect of prohibiting the Commission from usurping existing state jurisdiction over retail transmission service, whether bundled or unbundled. According to FL Com, FERC's jurisdiction over transmission terminates at the territorial boundary of each electric utility in Florida. It supports wheeling in jurisdiction for state commissions and wheeling out and wheeling through jurisdiction for the Commission.

IN Com opposes federalization of retail wheeling transactions within a state's boundaries as contrary to the FPA's legislative history and case law.

NJ BPU asserts that by claiming jurisdiction over unbundled retail transmission, the Commission is creating a disincentive for states to implement retail access because, by ordering retail access, the states may be relinquishing their jurisdiction over unbundled retail transmission terms and conditions -- jurisdiction that they would maintain under a bundled scenario.[459] PA Com argues that the Commission does not have the authority to order retail wheeling and that the jurisdictional formula is challengeable on engineering and legal grounds. It concludes that the Commission does not have jurisdiction over unbundled interstate retail transmission service. PA Com notes that the 1996 House and Senate hearings have **[30,339]** raised the question whether the Commission has the statutory authority to restructure the electric industry. PA Com questions the Commission's definition of the "traditional tasks of state and federal regulators" on the basis of section 201(b) of the FPA, the Supremacy Clause, and the Tenth Amendment of the U.S. Constitution.

Support Broader Assertion of Jurisdiction by the Commission Over Retail Wheeling

NY Utilities declare that the Commission has jurisdiction over retail wheeling from the source to the load, but does not have jurisdiction over transmission in bundled

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[459] *See also* PA Com.

retail service. They assert that the Commission's reliance on state jurisdictional local distribution as a predicate to abstain from allowing retail wheeling stranded cost recovery is without foundation. They further assert that a unique element that sets local distribution apart from transmission is not the size of the facility or the length of travel, but that transportation is bundled with a retail sale. According to NY Utilities, the plain meaning of the FPA shows that local distribution is bundled retail service. They claim that the legislative history, to the extent necessary, and court cases support FERC jurisdiction over all aspects of retail wheeling, but makes clear that the Commission cannot regulate bundled retail service. They add that the NGA also demonstrates that local distribution means bundled retail service.

Commission Conclusion

In concluding that this Commission has exclusive jurisdiction over the rates, terms and conditions of unbundled retail transmission by public utilities in interstate commerce, the Commission in Order No. 888 thoroughly examined the statutory language of the FPA and its legislative history, and relevant FPA and NGA case law. While the state commissions on rehearing would like us to draw a bright line that gives them, to varying degrees, jurisdiction over retail interstate transmission by public utilities, no party on rehearing has raised any legislative history or case law that was not previously considered and that would support the proposition that states have jurisdiction over any unbundled transmission in interstate commerce. As explained below, we reaffirm our jurisdictional interpretation on rehearing and believe that it is

supported by the recent decision in *United Distribution Companies v. FERC.*[460]

Many of the rehearing arguments focus on the fact that states historically (even prior to the FPA) regulated retail transmission insofar as it was a component of bundled electric service to an end user, and they argue that by asserting jurisdiction over unbundled retail transmission, the Commission is somehow "taking away" jurisdiction the states previously had. The flaw in these arguments is their inherent assumption that jurisdiction over transmission service turns upon the question of whether the transmission service is being provided for "wholesale" or "retail" power sales. That is not the case. The question of jurisdiction rather turns upon the extent of the Commission's exclusive jurisdiction over transmission in interstate commerce under the FPA. The fact that states historically regulated most retail transmission service as a part of a bundled retail power sale is not the result of a legal requirement; it is the practical result of the way electricity has historically been bought and sold. However, the shape of power sales transactions is rapidly changing. Rather than claiming "new" jurisdiction, the Commission is applying the same statutory framework to a business environment in which, as discussed below, retail sales and transmission service are provided in separate transactions.

In the past, retails ales occurred almost exclusively on a bundled basis (i.e., the same entity provided a delivered

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[460]88 F.3d 1105, 1152-53 (1996) (*United Distribution Companies*).

product called electric energy and transmission was part and parcel of that product). The FPA clearly reserves the right to regulate retail sales of electric energy to the states. As we explained in the Final Rule, however, in today's markets, and increasingly in the future as more states adopt retail wheeling programs, retail transactions are being broken into products that are being sold separately: transmission and generation. Moreover, these products are being sold increasingly by two or more different entities. For example, a transaction may **[30,340]** involve transmission service from one or more transmission providers who move power from a distant generation supplier, over the interstate transmission grid, to an end user. Because these types of products and transactions were not prevalent in the past, the jurisdictional issue before us did not arise and, contrary to IL Com's argument, the Commission cannot be viewed as "disturbing" the jurisdiction of state regulators prior to and after the Attleboro case.[461]

As we also explained in the Final Rule, the legislative history of the FPA and the relevant case law similarly reflect the historical market structure in which electricity and transmission generally were bought on a bundled basis.[462] Today's unbundled world simply was not contemplated and the cases do not resolve dispositively this jurisdictional issue. The case law focuses primarily on the bright line between wholesale sales and retail sales of energy, and transmission in interstate as opposed to intrastate commerce. It does not

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[461] *Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927).

[462] The case law is addressed extensively in Appendix G to the Final Rule and will not be repeated here.

address unbundled retail interstate transmission.[463] We therefore have interpreted the case law in light of changed circumstances and have relied in the first instance on the plain wording of the statute. We find compelling that section 201 of the FPA, on its face, gives the Commission jurisdiction over transmission in interstate commerce without qualification; unlike our jurisdiction over sales of electric energy, which section 201 specifically limits to sales at wholesale, the statute does not limit our transmission jurisdiction over public utilities to wholesale transmission.

Since the time Order No. 888 issued, the D.C. Circuit has addressed a similar issue in interpreting section 1(b) of the NGA, the provision that parallels section 201(b) of the FPA. Under section 1(b), the Commission's jurisdiction does not apply "to the local distribution of natural gas or to the

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[463]On rehearing, several parties argue that at least one court case, *Wisconsin-Michigan Power Co. v. FPC*, 197 F.2d 472 (7th Cir. 1952), *cert. denied*, 345 U.S. 934 (1953) explicitly applied the wholesale/retail distinction to distinguish transmission and local distribution services. The Commission discussed this case in detail in Appendix C to the Final Rule, *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,974-75; *mimeo* at 22-25. As we stated there, the court's interpretation of the legislative history of the FPA was at odds with both the plain words of the statute as well as the language of the House Report on the FPA (H.R. Rep. No. 1318 at p. 27). It also did not mention the Senate Report on the FPA, which clearly recognized jurisdiction over all interstate transmission lines, whether or not a sale of energy is carried by those lines (S. Rep. No. 621 at p. 48). We therefore reject arguments that this single case is in any way dispositive of the issue before us.

facilities used for such distribution." Similarly, under section 201(b) of the FPA, the Commission shall not have jurisdiction, except as specifically provided, "over facilities used for the generation of electric energy or over facilities used in local distribution. . ." In responding to arguments regarding the scope of state authority over "local distribution" of natural gas, the court distinguished between bundled and unbundled sales:

> States have been -- and are still -- permitted to regulate LDCs' bundled sales of natural gas to end-users because those transactions include transportation over local mains and the retail sales of gas. In contrast, states have never regulated the terms and conditions of interstate pipeline transportation. When the gas sales element is severed -- i.e., unbundled -- from the transactions, FERC retains jurisdiction over the interstate transportation component." [*United Distribution Companies*, 88 F.3d at 1153 (footnote omitted) (emphasis in original).]

The court's reasoning is also applicable to and supports our jurisdictional determination in Order No. 888.

Several state commissions point to section 212(h) of the FPA and argue that Congress, in refusing to grant the Commission authority to order retail wheeling, left all jurisdiction over retail transmission to the states. We disagree. What Congress did in section 212(h) was to prohibit us from ordering transmission directly to an ultimate consumer. We readily recognize and respect this prohibition. However, the

ability to order retail **[31,341]** wheeling is a separate issue from whether we have jurisdiction over the rates, terms and conditions of retail wheeling in interstate commerce that is ordered by a state or that is provided voluntarily. Congress, in enacting section 212(h), did nothing to modify our jurisdiction under sections 201, 205 and 206 over the rates, terms and conditions of interstate transmission by public utilities.

Similarly, we reject FL Com's arguments that section 212(g) of the FPA prohibits the Commission from asserting any jurisdiction over unbundled retail transmission. Section 212(g) prohibits the Commission from issuing an order that is inconsistent with any state law that governs retail marketing areas of electric utilities. As we stated in the Final Rule, while our jurisdiction cannot affect whether and to whom a retail electric service territory (marketing area) is to be granted by the state, and whether such grant is exclusive or non-exclusive, neither can state jurisdiction affect this Commission's exclusive jurisdiction over the rates, terms and conditions of transmission in interstate commerce by public utilities. We also reject arguments by the FL Com that this Commission's jurisdiction over transmission terminates at the territorial boundary of each electric utility in Florida. This argument is flatly contrary to the longstanding interpretation of the FPA by the United States Supreme Court.[464]

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[464] *See FPC v. Southern California Edison Co.*, 376 U.S. 205 (1964) (*Colton* case). IN Com makes a similar argument and opposes "federalization" of retail wheeling within a state's boundaries. We reject this argument on the same basis.

Commission's Seven Factor Test

IL Com argues that the Commission should withdraw its technical test. It contends that retail wheeling jurisdiction should follow function and that the function served by public utility facilities in providing retail service does not change upon the unbundling of service to retail customers. According to IL Com, Commission jurisdiction would extend to the service of delivering electric energy by a public utility to wholesale customers, regardless of the nature and extent of the public utility's facilities used to make that delivery. Similarly, it asserts, state jurisdiction would extend to the service of delivering electric energy by a public utility directly to retail customers, regardless of the nature and extent of the public utility's facilities used to make that delivery.

NARUC argues that the seven-factor test does not result in the bright line discussed in *FPC v. Southern California Edison Company*, 376 U.S. 205 (1964). The facility-by-facility categorization of utility systems on a company-specific basis, it asserts, is hardly consistent with the Court's decision to make case-by-case analysis unnecessary.

OH Com asserts that the seven factors provide no useful insight into the nature of local distribution service. It adds that reliance upon technical tests to determine local distribution lacks legal foundation. It further contends that the jurisdictional bright line established by Congress focuses upon the nature of the transaction, not the functional or technical characteristics of a particular wire, in determining whose jurisdictional authority attaches to a particular transaction and facilities. It concludes that the Commission should adopt the

Ohio-proposed retail marketing area "wheeling in" jurisdictional approach.

PA Com contends that the Commission's seven indicia are not acceptable measures of local distribution and challenges each factor.

NH & MI Coms declare that the criteria for distinguishing transmission facilities from local distribution facilities should not be limited to the seven given in the Rule, but should allow consideration of any other relevant criteria for separating local concerns from matters legitimately federal in nature.

NJ BPU argues that the engineering-driven definition does not resolve many of the hazy areas. To the extent that the seven factors do not reflect or cannot be reconciled with the particular circumstances, it contends that the states may be hamstrung in their ability to make **[30,342]** reasoned decisions that comport with Order No. 888.[465]

Similarly, NY Com argues that five of the seven factors (1, 2, 4, 6,and 7) are not accurate when applied to large metropolitan areas and remote rural areas. It asserts that local distribution facilities are not necessarily close to retail customers and the assumption that local distribution facilities

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[465] *See also* WI Com (criteria do not appropriately reflect the mixed nature of many facilities in systems that are closely integrated and the application of the criteria to the electric system in Wisconsin would supplant state jurisdiction over a large number of facilities whose primary functions are local reliability and retail service).

are primarily radial in character fails to account for network systems. It adds that reconsignment or transportation of power to different markets can and does occur at the local distribution level. It further adds that the presence of meters is not a discerning characteristic of where interstate transmission ends and local distribution begins; meters are frequently not part of the transmission/local distribution interface. Nor, according to NY Com, are local distribution systems necessarily of reduced voltage. Instead of the 7 criteria, NY Com argues that the Commission should adopt a functional measure of local distribution based on factors 3 and 5 (interstate transmission ends and local distribution begins where electricity flows into a comparatively restricted geographic area and does not flow back out of that area and the power is consumed in that area) and on the traditional classification of the facilities by the state regulatory body (or what the utility has traditionally classified as local distribution).

Commission Conclusion

Several parties on rehearing do not like the seven-factor technical test for local distribution facilities that was set forth in Order No. 888. That test takes into account both technical and functional characteristics of the transaction involved. The parties on rehearing propose instead a variety of bright line tests. For example, IL Com wants state jurisdiction to extend to the "service" of delivering electric energy to retail customers, which it would define to give it jurisdiction regardless of the nature and extent of the facilities used to make the delivery. OH Com proposes that the Commission adopt a retail marketing area "wheeling in"

jurisdictional approach which would give it jurisdiction over facilities within territorial boundaries.

In response, we do not interpret the FPA to permit us in effect to rewrite the statute to give states jurisdiction over interstate transmission services. Moreover, we reject arguments of OH Com that our seven-factor test lacks legal foundation, and arguments of NARUC that we are somehow bound to develop a bright line test. While Congress established a jurisdictional bright line between wholesale and retail sales of energy, there is no such bright line that we can divine with regard to transmission and local distribution facilities. The Supreme Court, in both Colton and CL&P,[466] has instructed us that whether facilities are used in local distribution is a question of fact to be decided by the Commission as an original matter. The seven factors will permit us to undertake this fact-specific determination.

We acknowledge the concerns raised by several state commissions that the seven-factor test does not, as NJ BPU puts it, resolve many of the hazy areas, and that there may be other factors that should be taken into account in particular situations. The seven-factor test is intended to provide sufficient flexibility to take into account unique local characteristics and historical usage of facilities used to serve retail customers. We specifically stated in the Final Rule that we will consider jurisdictional recommendations by states that take into account other technical factors that states believe are appropriate in light of historical uses of particular facilities.

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[466] *See Colton*, 376 U.S. at 210 n.6; CL&P, 324 U.S. at 531-36.

Moreover, we will defer to facility classifications and/or cost allocations that are supported by state regulatory authorities. For example, in the ongoing California electric utility restructuring proceeding, the Commission deferred to the State PUC's recommendations regarding the split between state-jurisdictional local distribution facilities and Commission-**[30,343]** jurisdictional transmission facilities.[467]

Oppose transmission of public utility purchases for sale at retail

IL Com objects to the transmission unbundling requirement if it is intended to require public utilities to take transmission services under their own FERC tariffs for purchases of power intended for distribution by the public utility to retail customers. According to IL Com, a distinction must be made between the public utility's use of its transmission system in cases in which the public utility purchases wholesale power for sale for resale, and cases in which the public utility purchases wholesale power to serve native load retail customers. It argues that the Commission cannot legally regulate, or place conditions on, the manner in which a utility uses its transmission system to make sales of electric energy at retail. It contends that the Commission must exempt public utility power purchases for sale at retail from the unbundling requirement. It recommends that the Commission insert the words "for sale for resale" after the word "purchases" in section 35.28(c)(2) and after the word "purchase" in section 35.28(c)(2)(i).

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[467] *Pacific Gas and Electric Company, et al.*, 77 FERC ¶61,325 at p. 61,325 (1996).

Commission Conclusion

The Commission rejects arguments of IL Com that if unbundled retail wheeling occurs either voluntarily or as a result of a state retail program, we cannot require the utility to take service under its own transmission tariff for sales to retail customers. This requirement is a term and condition of unbundled retail interstate transmission service and, as explained above, therefore is within our exclusive jurisdiction. Additionally, this should not in any way infringe on state retail programs or service to retail customers. Rather, it ensures that non- discriminatory transmission services are provided to all potential retail power competitors.

Further, as stated previously in Section IV.C.1.b (Transmission Providers Taking Service Under Their Tariff), we clarify that a transmission provider does not have to "take service" under its own tariff for the transmission of power that is purchased on behalf of bundled retail customers.

Oppose buy-sell transaction analysis

PA Com asserts that there is a potential for jurisdictional conflict with respect to buy-sell transactions that is a direct consequence of the technical-functional test (which PA Com challenges).

IL Com argues that states have exclusive authority to regulate buy-sell arrangements as bundled retail sales. It further argues that the Commission cannot make a bundled retail sale into an unbundled retail sale simply by characterizing it as the functional equivalent of an unbundled retail sale; by re-characterizing them the Commission is

effectively ordering the unbundling of buy-sell arrangements. It asserts that buy-sell arrangements on the electric side are not an end run around clear federal jurisdiction and that the Commission should withdraw its assertion of jurisdiction over the retail transmission component of unbundled retail sales.

VT DPS contends that the Commission's rationale is flawed: "FERC's analysis rests on the same very shaky ground as its similar claim of jurisdiction over buy-sell arrangements by local gas distribution companies." According to VT DPS, all retail transactions are subject to state jurisdiction and asks the Commission to clarify that the Commission defines buy-sell as it did in the NOPR, but also acknowledge that it has no jurisdiction over such arrangements.

IN Com asserts that in the absence of any record of abusive and undermining actions by states under the guise of buy-sell arrangements, there is not even a remedial justification to touch buy-sell transactions. It contends that a difference between the FPA and the NGA warrants different treatment -- the FPA exempts from FERC jurisdiction local distribution and transmission of electric energy in intrastate commerce. By redefining interstate transmission, IN Com claims that the Commission proposes to do away with the meaning history has accorded to a variety of transactions previously considered wholly intrastate in nature. According to IN Com, states should be allowed **[30,344]** to experiment with and allow different forms of buy-sell transactions as part of the evolving marketplace.

Commission Conclusion

Four parties (PA Com, IL Com, VT DPS and IN Com) have raised concerns regarding the Commission's determination that it has jurisdiction over the interstate transmission component of transactions in which an end user arranges for the purchase of generation from a third party. The Commission reiterates that we will have to address these situations on a case-by-case basis. We disagree with IL Com that States have exclusive authority to regulate the interstate transmission component of buy-sell transactions. Similarly, we deny the VT DPS request that we acknowledge no jurisdiction over such arrangements. The fact remains that these arrangements could be used by parties to obfuscate the true transactions taking place and thereby allow parties to circumvent Commission regulation of transmission in interstate commerce. We reserve our authorities to ensure that public utilities and their customers are not able to circumvent non-discriminatory transmission in interstate commerce. In response to VT DPS' contention that the Commission's analysis here rests on the same shaky ground as its similar claim of jurisdiction over buy-sell arrangements by local gas distribution companies, we note that the D.C. Circuit recently affirmed the Commission's assertion of jurisdiction over buy/sell arrangements under the Natural Gas Act.[468]

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[468] *United Distribution Companies*, 88 F.3d at 1154-57.

State jurisdiction over the service of delivering electric energy to end users

Rehearing Requests

IL Com states that it is far from clear what FERC contemplates by the "service" of delivery of electric energy by a delivering utility in the retail wheeling transaction. It is equally unclear to IL Com whether the "service" to which Order No. 888 refers is a public utility activity over which state regulators would have jurisdiction. IL Com argues that it is the Illinois legislature, not FERC, that determines whether IL Com can regulate something called "delivery service."[469]

MO/KS Coms ask the Commission to clarify the meaning of the statement that even when the test for local distribution facilities identifies no local distribution facilities, the Commission believes that states have authority over the service of delivering electric energy to end users. According to MO/KS Coms:

> The authority to shop at retail and to sell at retail do not exist in the FPA. If the Commission's goal is to recognize the States' authority to establish conditions on retail competition, it need only acknowledge the

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[469] *See also* AK Com (should not create a fictional concept of delivery service -- the legal reality is that, under retail competition, state law will establish a customer's right to be served and a generation owner's right to produce power. AK Com asserts that the state can then attach conditions to those rights).

> State jurisdiction to establish the opportunity to shop and sell at retail. If this is what the Commission is seeking to accomplish by its discussion of 'delivery service,' then we support the Commission."[470]

Coalition for Economic Competition asserts that the Commission failed to consider that the sale of electric energy may take place outside of the state into which the energy is transmitted, and that the local regulatory commission may have no jurisdiction over either the sale or the transmission of the energy.

Commission Conclusion

Several parties ask us to clarify our conclusion that even when the seven-factor test for local distribution facilities does not identify local distribution facilities, we believe states have authority over the "service" of delivering electric energy to end users. We clarify that states have the authority to determine the retail marketing areas of electric utilities within their jurisdictions, and the end user services that those utilities must provide, but we did not in Order No. 888 intend to opine on the extent of authority given by state legislatures to their state commissions. Rather, our statement regarding state authority over the "service" of delivering electric energy is intended to recognize the historical and local nature of delivering power to end users and the **[30,345]** states' legitimate concerns and responsibilities in regulating local matters.

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[470]MO/KS Coms at pp. 1-13.

Deference to states

Rehearing Requests

Support broader deference

NARUC and IL Com argue that the Commission should not simply defer to state recommendations concerning the application of the seven-factor test or the recovery of stranded costs, but should conclusively rely on the findings by state commissions.

NY Com argues that the Commission should not limit deference to instances in which states order retail wheeling, but should defer to all state commission recommendations regarding the definition of local distribution facilities.

FL Com asserts that the Rule fails to say where deference will be given. It argues that the Rule should state that when a state commission has held a proceeding on matters related to the requirements of the Rule, the Commission shall give deference to the state commission decisions. Moreover, it asserts that the Commission should codify the deference standard: "When a state commission has held a proceeding on matters related to the requirements of this rule, the Commission shall give deference to the state commission decisions." (FL Com at pp. 7-9).

The commitment to defer to a state regulatory commission or agency, argues NE Public Power District, should be clarified with respect to utilities located in Nebraska, which has no such commission or agency. NE Public Power District assumes that deference will be accorded

to decisions of NE Public Power District's Board of Directors; if not, it asks the Commission to clarify.

PA Com asks the Commission to clarify what a state regulatory agency must demonstrate to secure deference and to define the term "consult." PA Com states that, in discussing the seven indicia, the Commission states that it will "consider" jurisdictional recommendations by states, which PA Com asserts is much different from deference. It also asserts that the Commission must clarify what it will do if a utility's classifications and/or cost allocations are not supported by state regulatory authorities.

Oppose deference to state authorities

TANC argues that the Commission erred in deferring to state regulatory authorities in drawing jurisdictional lines for local distribution facility classifications and/or cost allocations. According to TANC, the Commission unlawfully and unnecessarily abdicated its jurisdiction under the FPA (citing *New England Power Co. v. New Hampshire*, 455 U.S. 331, and *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953). With respect to ISOs, it asserts that the Commission should not defer to state authority in making determinations with respect to classifications of facilities.

Commission Conclusion

In response to NARUC and IL Com's arguments that this Commission should not simply defer to state commissions regarding application of the seven-factor test but instead should conclusively rely on the findings of state commissions, we believe this is inconsistent with the case law which states

that local distribution it is a matter of fact for the Commission to determine as an original matter.[471] Additionally, we have an independent obligation to ensure that we are fulfilling our responsibilities under the FPA to regulate facilities that are used in interstate commerce. We cannot delegate our jurisdiction. However, we intend to provide broad deference to states in determining what facilities are Commission-jurisdictional transmission facilities and what facilities are state-jurisdictional local distribution facilities, so long as our comparability principles are not compromised and we are able to fulfill our responsibilities under the statute.

We reject FL Com's suggestion that we codify the deference standard. This is neither necessary nor appropriate. In response to NE Public Power District's request that we clarify to whom we would give deference in Nebraska, we clarify that because Nebraska does not have an electric regulatory commission or agency, there is no appropriate regulatory entity to whom our deference standard would apply; accordingly, we will address the **[30,346]** transmission/local distribution issue for Nebraska without giving deference to any particular entity. In response to PA Com's request that we clarify what we will do if a utility's classifications and/or cost allocation proposals are not supported by state regulatory authorities, we will make a determination based on the factual record before us in a particular case, taking into account the views of the state regulatory authority.

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[471] *See Colton and Connecticut Light and Power, supra.*

TANC has argued that we have unlawfully abdicated our jurisdiction by deferring to state recommendations. TANC confuses delegation of jurisdiction, which we cannot do, with willingness to defer to states based on their application of criteria that we have provided. Even in the cases in which the Commission defers to states' views, we will still independently evaluate all material issues and proceed only where substantial evidence supports the states' views. The Commission clearly can entertain requests for deference in these circumstances.

J. *Stranded Costs*

As indicated in our prior discussion in Section IV.A.5, there are two major overlapping transition issues that arise as a result of this rulemaking: stranded cost recovery and how to deal with contracts entered into under the prior regulatory regime. We here address stranded cost recovery and, as in the prior discussion, we believe it is important to explain the general context in which our stranded cost determinations have been made before addressing the various rehearing requests on this issue.

In Order No. 888, the Commission removed the single largest barrier to the development of competitive wholesale power markets by requiring non-discriminatory open access transmission as a remedy for undue discrimination. This action carries with it the regulatory public interest responsibility to address the difficult transition issues that arise in moving from a monopoly, cost-based electric utility industry to an industry that is driven by competition among wholesale power suppliers and increasing reliance on market-based generation rates. The most critical transition issue that

arises as a result of the Commission's actions in this rulemaking is how to deal with the uneconomic sunk costs that utilities prudently incurred under an industry regime that rested on a regulatory framework and a set of expectations that are being fundamentally altered.

The Commission determined in Order No. 888 that it must address stranded costs, and that it must do so at an early stage -- particularly in light of the lessons learned from our experience with similar issues in the natural gas area. We noted that when we did a similar restructuring in the gas industry, the D.C. Circuit invalidated the Commission's efforts precisely because the Commission had failed to deal with the stranded cost problem in a satisfactory manner.[472] We explained that, based on the lesson of AGD, the Commission cannot change the rules of the game without providing a mechanism for recovery of the costs caused by such regulatory-mandated change.

Since the time Order No. 888 issued, we have been provided with additional guidance from the court in the natural gas area, which has further helped to inform our decisions here. In its decision on review of Order No. 636,[473] the D.C. Circuit upheld the Commission's decision to allow the recovery of gas supply realignment costs. In so doing, the court, while questioning a specific feature of the stranded cost recovery mechanism employed in Order No. 636, has

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[472] *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988) (*AGD*).

[473] *United Distribution Companies v. FERC*, 88 F.3d 1105 (1996) (*United Distribution Companies*).

nevertheless again reaffirmed the basic principle that stranded cost recovery is an appropriate component of a regulatory policy aimed at accomplishing a fair and reasonable transition to competitive markets. The question as to the Commission's ability to allow the recovery of stranded costs has been laid to rest.

The task before the Commission in this rulemaking is thus to determine how best to meet its responsibility to address the costs of the transition to a competitive industry, particularly insofar as those costs are stranded, or in effect rendered unrecoverable, as a result of the transmission access required by us under the **[30,347]** FPA.[474] As the rehearing arguments demonstrate, there is no consensus on how the Commission should address the stranded cost issue. In fact, petitioners are at polar extremes as to what the Commission should do regarding stranded costs. Some argue that the Commission has gone too far in permitting utilities to seek recovery of stranded costs, whether such costs are associated with wholesale requirements contracts, with retail-turned-wholesale customers, or with retail customers that obtain retail wheeling.[475] Others argue that the Commission has not

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[474]Such access may be the open access required under this Rule or case-by-case transmission access ordered pursuant to FPA section 211.

[475]We note that the regulations implementing this Rule use "wholesale stranded cost" and "retail stranded cost" as shorthand terms to refer to the different situations in which a utility may experience stranded costs. However, as the definitions of those terms make clear, it is not the nature of the costs (wholesale vs. retail) that is controlling for purposes of stranded cost recovery

gone far enough and that it must broaden the scope of stranded cost recovery permitted under the Rule. Indeed, some would have us be the guarantor for recovery of all uneconomic costs that might be stranded in the move to more competitive markets, no matter how tenuous the nexus to this Rule, and irrespective of state-Federal jurisdictional complexities. Some support the Commission's decision to recover stranded costs directly from the departing customers. Others would prefer that the Commission require utilities to absorb a portion of their stranded costs or that the Commission spread the burden of stranded costs among all of the utility's customers. Some object that the Commission's approach to stranded costs in the electric industry is different from that adopted in the gas industry. Some entities support the Commission's revenues lost approach for measuring a departing customer's stranded cost obligation. Others propose different methods for computing stranded costs.

Given the plethora of positions that entities have raised both initially and on rehearing concerning stranded costs, the Commission has taken a careful, measured approach with regard to stranded cost recovery. The Commission has balanced a number of important interests in order to achieve what it believes will be a fair and orderly transition to

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under this Rule. Rather, the controlling factors are the status of the customer (wholesale transmission services customer vs. retail transmission services customer) with whom the costs are associated, and whether the transmission tariffs used by the customer to escape its former power supplier (thus causing the stranding of costs to occur) were required by this Commission or by a state commission. As a result, "retail stranded costs" refers to stranded costs associated with retail wheeling customers.

competitive markets. These interests include the financial stability of the electric utility industry, upholding the regulatory bargain under which utilities made major capital investments, and not shifting costs to customers that had no responsibility for causing those costs to be incurred. The Commission also has adopted an approach that, for purposes of stranded cost recovery from wholesale transmission customers, relies on the nexus between stranded costs and the use of transmission tariffs required by this Commission and, for purposes of stranded cost recovery from retail customers, recognizes state commission jurisdiction but fills potential regulatory gaps that could arise in the transition to new market structures.

The balancing of interests and considerations described above is reflected in the following central components of the Rule's stranded cost provisions, which are reaffirmed herein.[476] First, the Commission has determined that the most reasonable, legally supportable approach is one that permits utilities to seek recovery of wholesale stranded costs under this Rule (whether the stranded costs are associated with a departing wholesale requirements customer or with a retail-turned-wholesale customer) only in those cases in which there is a *direct nexus* between the availability and use of Commission-required transmission access[477] and the **[30,348]**

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[476]We reaffirm below our basic determinations, but make certain clarifications on limited issues and grant rehearing on the municipal annexation issue.

[477]As we explain below, by "Commission-required transmission access" we mean the open access transmission required under this Rule or required pursuant to a section 211

stranding of costs. In order for the utility to be eligible to seek recovery of stranded costs from a departing customer, the customer must have obtained access to a new generation supplier through the use of the former supplying utility's Commission-required transmission tariff (i.e., its open access tariff or a tariff ordered pursuant to FPA section 211), not through the use of another utility's transmission system.

Other cost recovery issues are more appropriately addressed outside the context of this Rule. For example, the Rule is not intended to apply to costs associated with the normal risks of competition, such as self-generation, cogeneration, or loss of load, that do not arise from the new, accelerated availability of Commission-required transmission access. If a customer leaves its utility supplier by exercising options that could have been undertaken prior to mandatory transmission under Order No. 888 or the Energy Policy Act, or that do not rely on access to the former seller's transmission, there is no direct nexus to Commission-required transmission access and thus no opportunity for stranded cost recovery under the Rule.

Second, the Commission has limited the opportunity to seek stranded cost recovery under the Rule primarily to two discrete situations: (1) costs associated with customers under wholesale requirements contracts executed on or before July 11, 1994 (referred to in the Rule as "existing wholesale

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order, as well as transmission provided prior to Order No. 888 (and not pursuant to a section 211 order) where such transmission was provided on a case-by-case basis to comply with the Commission's comparability requirement. *See* note 484 *infra*.

requirements contracts") that do not contain an exit fee or other explicit stranded cost provision; and (2) costs associated with retail-turned-wholesale customers. With regard to the existing wholesale requirements contracts, the Commission also has made a finding that it is in the public interest to permit amendments to add stranded cost provisions to these contracts, even if they contain *Mobile-Sierra* clauses, if case-by-case evidentiary burdens are met. We do not interpret the *Mobile-Sierra* public interest standard as practically insurmountable in extraordinary situations such as this one where historic statutory and regulatory changes have converged to fundamentally change the obligations of utilities and the markets in which they and their customers will operate.

Third, Order No. 888 *does not guarantee* that a utility will be allowed to recover stranded costs. Rather, it provides an opportunity for such recovery. To be eligible to recover stranded costs from a departing customer in a particular case, the utility must demonstrate that it incurred costs to provide service to the customer based on a reasonable expectation of continuing service to that customer beyond the contract term.[478] In the case of stranded costs associated with wholesale requirements contracts customers, if the contract contains a notice of termination provision, that provision is strong evidence that the parties were aware that at some point in the future the customer might seek to find another supplier.

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[478]We have made a minor revision to the regulatory text, section 35.26(c)(2), to conform the language of that section with sections 35.26(b)(1) and (5). A conforming revision has been made to section 35.26(d)(2)(i).

Therefore, there is a rebuttable presumption of no reasonable expectation, and therefore no opportunity for stranded cost recovery unless the utility can overcome the presumption.

The Commission has concluded that direct assignment of stranded costs to the departing customer (through either an exit fee or a surcharge on transmission) is the appropriate method for recovery of stranded costs under the Rule. In reaching this conclusion, the Commission carefully weighed the arguments supporting direct assignment of stranded costs against those supporting a more broad-based approach, such as spreading stranded costs to all transmission users of a utility's system, and also took into account the fact that we applied a different approach in the natural gas area. The central considerations that support a direct assignment approach in the electric industry are that the approach follows the traditional regulatory concept of cost causation, it avoids shifting costs to customers that had no responsibility for causing them to be incurred or for causing them to be stranded, and it is still possible to apply such an approach at this stage of the industry's evolution.

[30,349]

There is no question that, without the stranded cost recovery mechanism, some customers would be far more likely to switch to lower-cost suppliers and enjoy sooner the benefits of a competitive power market. But, as detailed in Order No. 888, such an approach may result in higher costs for other customers. We thus have had to balance the potential for earlier benefits for some customers against other public interest considerations, most particularly the need to provide a fair mechanism by which utilities can recover the costs of past investments under traditional regulatory concepts of

prudently incurred costs and cost causation. The result is not to deny competitive advantages, but only to delay their full realization for some customers so that all customers ultimately will benefit.

While Order No. 888's cost causation approach is different from the Order No. 636 cost spreading approach that was affirmed in the *United Distribution Companies* case, we believe it is the preferable approach given the early stage of the electric utility's competitive transition. We do not read the court's opinion as precluding the Commission from adopting a direct assignment approach in Order No. 888, particularly where, as here, the Commission has fully explained and justified the reasons for following traditional cost causation principles. In addition, although the *United Distribution Companies* court remanded for further consideration (in light of Order No. 636's cost spreading approach) the decision not to require any pipeline absorption of gas supply realignment costs, the Commission has fully explained how its decision in Order No. 888 not to require any utility absorption of stranded costs is consistent with its decision to follow traditional cost causation principles. With respect to the fundamental conclusion that utilities should be permitted an opportunity to recover their prudently incurred costs, Order No. 888 is fully consistent with Order No. 636. Although the Commission in Order No. 888 chose a direct assignment method (rather than the cost-spreading approach in Order No. 636) for purposes of allocating stranded cost responsibility among customers, the approach used by the Commission in Order No. 888 is not governed by decisions in Order No. 636, but in either event the Commission must demonstrate that its choice of methods is based on reasoned decision-making.

In considering the stranded cost issues that may arise in the transition to competitive markets, the Commission also has taken cognizance of significant changes involving retail customers and the stranded cost issues that arise as retail customers convert to wholesale customer status (*e.g.*, through municipalizations) in order to obtain the open access afforded by Order No. 888, or as they obtain retail wheeling required by state commissions. These situations involve new and complex jurisdictional issues and represent the bulk of potential stranded costs facing the industry. We believe it is important to clarify the Commission's decisions as to when it will entertain requests for stranded cost recovery in these situations, and our reasons for doing so.

The Commission's determination that it, rather than the states, should be the primary forum for addressing stranded costs associated with a retail-turned-wholesale customer[479] is limited to those cases in which there is a *direct*

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[479]In Order No. 888 and here, we sometimes use the shorthand expression "retail-turned-wholesale" customer. By this we do not mean that a retail customer who is an ultimate consumer ceases to be an ultimate consumer, or that this customer begins to purchase electric energy for resale. Rather, in a "retail-turned-wholesale customer" situation, such as the creation of a municipal utility system, a newly- created entity becomes a wholesale power purchaser on behalf of retail customers who were formerly bundled customers of the historical local utility power supplier. The new municipal utility is the conduit by which retail customers, if they cannot obtain direct retail access, can reach power suppliers other than their historical local utility power supplier. Although the retail customers remain bundled retail customers, in that they become the bundled customers of the new entity, we call this a "retail-turned-

nexus between the availability and use of Commission-required transmission access and the stranding of costs. We believe we have both the authority and the obligation to provide an opportunity stranded cost recovery in these situations because the bundled retail customer would not be able **[30,350]** to obtain access to the new supplier *but for* the Commission's order requiring transmission. The creation of a new wholesale entity to purchase power on behalf of retail customers would not, by itself, trigger stranded costs. IN the absence of transmission access from the historical supplier of the retail customers, the new entity would have to remain on the historical supplier's generation system because it would have no way to reach other power suppliers and stranded costs would not occur.[480] Therefore, there is a causal nexus between the stranded costs and the availability and use of the tariff services *required by the Commission*.[481] Moreover, because of

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wholesale customer" situation because the new entity in effect "stands in the shoes" of the retail customers for purposes of obtaining wholesale transmission access and new power supply.

[480]Exceptions would be self-generation or construction by the new entity of its own transmission line, in which case, as noted earlier, the stranded cost provisions of Order No. 888 would not apply because such options have always been available as alternatives to purchasing power from the historical supplying utility and do not involve the use of the utility's transmission facilities under an open-access tariff. Thus the departure of customers under these circumstances cannot be linked to the open-access requirements of this Rule.

[481]As discussed in greater detail in sections IV.J.6 and IV.J12 below, we clarify that the opportunity for recovery of stranded costs in a retail-turned-wholesale situation is limited to

this causal nexus between the use of a jurisdictional utility's Commission-required transmission tariff and the potential for foregone revenues by that jurisdictional utility as a result of the Commission-required access, the stranded costs associated with a retail-turned-wholesale customer are properly viewed as economic costs that are jurisdictional to this Commission.

In contrast, in the situation in which a bundled retail customer obtains retail wheeling, stranded costs are directly caused by the availability and use of unbundled retail services *required by the state commission*, not this Commission.[482] Thus, the Commission believes that states, not the Commission, should be the primary forum for costs associated with a bundled retail customer that obtains retail wheeling. The Commission's decision to entertain requests to recover stranded costs caused by retail wheeling in *only* a limited circumstance (where the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required) is based on a policy decision

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cases in which the former bundled retail customer subsequently becomes, either directly or through another wholesale transmission purchaser, an unbundled wholesale transmission services customer of its former supplier. We have revised section 35.26(b)(1)(i) of the Commission's regulations accordingly.

[482]Unbundled retail transmission services required by a state commission could be taken under the same *pro forma* open-access tariff sued by wholesale customers or, if determined appropriate by the Commission, under a separate retail tariff filed at the Commission. The critical point, however, is that in either case, the unbundled services are required by the state and not by this Commission.

by the Commission that it will step in to fill a regulatory "gap" that could result in no effective forum in which utilities would have an opportunity to seek recovery of prudently incurred costs.

Finally, after considering various proposals regarding how stranded costs should be calculated, and reviewing the arguments of petitioners on rehearing, the Commission continues to believe that the revenues lost approach is the fairest and most efficient way to determine the amount of stranded cost assigned to a departing customer during the transition to a competitive wholesale bulk power market. The Commission has rejected an asset-by-asset approach as overly complicated and costly.

We respond below to the specific arguments raised on rehearing and elaborate on the above determinations.

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[pp. 30,402-30,424]

[30,402]

6. Recovery of Stranded Costs Caused by Retail- Turned-Wholesale Customers

In Order No. 888, we concluded that this Commission should be the primary forum for addressing the recovery of stranded costs caused by a retail-turned-wholesale customer.[672]

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[672] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,818-19; *mimeo*

We stated that if such a customer is able to reach a new generation supplier because of the new open access (through the use of a FERC-filed open access transmission tariff or through transmission services ordered pursuant to section 211 of the FPA), any costs stranded as a result of this wholesale transmission access should be viewed as "wholesale stranded costs." We explained that there is a clear nexus between the FERC-jurisdictional transmission access requirement and the exposure to non-recovery of prudently incurred costs and that, in these circumstances, this Commission should be the primary forum for addressing recovery of such costs.[673]

We said we will not be the primary forum for stranded cost recovery in situations in which an existing municipal utility annexes territory served by another utility or otherwise expands its service territory. We indicated that in these situations there is no direct nexus between the FERC-jurisdictional transmission access requirement and the exposure to non-recovery of prudently incurred costs. The risk of an existing municipal utility expanding its territory was a risk prior to the Energy Policy Act and prior to any open access requirement.

Nevertheless, we did express concern that there may be circumstances in which customers and/or utilities could

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at pp. 534-37.

[673]We indicated that we will require the same evidentiary demonstration for recovery of stranded costs from a retail-turned-wholesale customer (and will apply the same procedures for determining stranded cost obligation) as that required in the case of a wholesale requirements customer.

attempt, through indirect use of open access transmission, to circumvent the ability of any regulatory commission -- either this Commission or state commissions -- to address recovery of stranded costs. We reserved the right to address such situations on a case-by-case basis.

Rehearing Requests Opposing Retail-Turned-Wholesale Jurisdiction

A number of entities challenge the Commission's assertion that costs associated with retail-turned-wholesale customers would not be stranded but for the FERC-jurisdictional transmission access requirement. They assert that the condition precedent to municipalization is the operation of a state process, and thus that it cannot be the case that the recovery of costs caused by a retail-turned-wholesale customer is "not subject to regulation by the States." They submit that such costs would not be stranded but for the action of state legislators or state regulators in granting authority for the customer's status change. They argue that any nexus that the Commission's authority under the FPA has to wholesale transmission services subsequently provided to the new **[30,403]** wholesale customer is entirely derivative of the state's action.[674]

A number of entities argue that jurisdiction over costs that are stranded when a retail customer becomes a wholesale customer should be left to the states because the facilities used to provide retail service to these retail customers were subject

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[674] *E.g.*, NARUC, TAPS, Nucor, Suffolk County, IL Com, Multiple Intervenors, APPA, CAMU, WI Com, NASUCA.

to state jurisdiction and were included in retail rate base when the service was rendered.[675] They argue that because the Commission had no jurisdiction over the public utility facilities and costs incurred to serve retail-turned-wholesale customers, it has no jurisdiction to address those public utility costs if they become stranded. Thus, according to these entities, the conversion of the customer from retail to wholesale does not simultaneously effectuate a conversion of the costs from retail to wholesale.

AR Com and MO/KS Coms submit that jurisdiction over the costs incurred for historical retail customers does not shift unless the parties themselves make those costs a part of their new wholesale contract. NY Com submits that the Commission should recognize the states' jurisdiction to set the level of stranded costs associated with retail-turned-wholesale customers to be recovered in wholesale transmission rates set by FERC. FL Com asserts that state authorities are in a better position to assess the extent of stranded facilities and their costs, and that the Commission's involvement should be limited to that requested by a state by petition.

OH Com states that the Commission's position on stranded costs associated with retail-turned-wholesale customers invites second-guessing of state commission determinations and encourages forum shopping by introducing more than one stranded cost treatment within a single state jurisdiction. It expresses concern that utilities may seek to

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[675] *E.g.*, ELCON, IL Com, IN Com, American Forest & Paper, AR Com, MO/KS Coms, NJ BPU, Suffolk County, WY Com, VA Com, FL Com, NARUC, TAPS.

creatively disaggregate into generation, transmission, and distribution companies in ways to deliberately recast traditional retail relationships as wholesale in an effort to obtain favorable regulatory treatment of stranded costs.

IN Com submits that Order No. 888's treatment of stranded costs associated with retail-turned-wholesale customers will discourage state legislatures from making municipalization more available. VT DPS and Valero argue that the threat of a stranded cost surcharge will erect a new barrier to the formation of municipal utilities. They note that the Rule refers to one commenter's observation that, if *Otter Tail* could have made a stranded cost claim against the municipal utility that Elbow Lake planned to create, *Otter Tail* would not have needed to refuse to wheel and there would never have been an *Otter Tail* case. They submit that the Commission never addressed whether, or why, it believed the point to be wrong.

VT DPS and Valero also assert that the Rule represents a major inconsistency with prior Commission treatment of municipalization. They submit that the Commission historically promoted franchise competition between municipalities and utilities by holding tariff provisions that restrict such competition to be anticompetitive and unreasonable.[676]

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[676]VT DPS and Valero cite in this regard *Florida Power & Light Company*, 8 FERC ¶61,121 (1979); *Power Authority of the State of New York v. FERC*, 743 F.2d 93 (2d Cir. 1984); *Metropolitan Transportation Authority v. FERC*, 796 F.2d 584 (2d Cir. 1986).

American Forest & Paper submits that recovery of 100 percent of stranded costs caused by municipalization is inconsistent with the Commission's actions in the natural gas industry, where the Commission has encouraged competition at the retail level through competitive bypass and has not created barriers to competitive entry by imposing transition charges or exit fees on converting customers.[677]

Nucor objects that the Rule does not address the substantive findings, the common sense rationale, or the jurisdictional distinction drawn in *United Illuminating*.**[30,404]**[678] It contends that the Commission's observation in Order No. 888 that there may not be a state regulatory forum for the recovery of stranded costs associated with retail-turned-wholesale customers and hence that the Commission should be the primary forum for addressing such stranded costs is flawed because there always is a state forum to address such cost recovery (the adequacy of the relief provided is a very distinct issue) and open access transmission does not and cannot cause retail competition to occur.[679]

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[677] American Forest & Paper cites in support of its position Great Lakes Gas Transmission Limited Partnership, 68 FERC ¶61,376 (1994).

[678] *United Illuminating Company*, 63 FERC ¶61,212, *reh'g denied*, 64 FERC ¶61,087 (1993) (*United Illuminating*).

[679] *See also* Suffolk County Rehearing (Commission's analysis in *United Illuminating* was correct; nothing has changed to warrant the Commission's rejection of that analysis).

Commission Conclusion

We will reject the requests for rehearing of our decision to be the primary forum for addressing the recovery of stranded costs caused by retail-turned-wholesale customers. We find the requests for rehearing on this issue unpersuasive. While it may be the case, as some entities suggest, that state action is a condition precedent to municipalization, the rehearing petitions ignore the fact that the Rule covers situations in which open access is also a condition precedent to the municipalized customers leaving their existing supplier's system. Order No. 888 does not propose that the Commission be the primary forum for stranded cost recovery for all cases of municipalization. Instead, our holding is limited to those cases in which the new wholesale entity uses Commission-mandated transmission access to obtain new power supply on behalf of retail customers that were formerly supplied power by the utility providing the transmission service.[680]

As we explained in Order No. 888, in such cases there is a direct nexus between the FERC-jurisdictional transmission access requirement and the exposure to non-recovery of costs stranded as a result of this wholesale transmission access. Thus, the stranded costs associated with

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[680]In the case of municipalization, the bundled retail customers of a local utility become the bundled retail customers of the new municipal utility. As explained above, we call this a "retail-turned-wholesale customer" situation because the new municipal entity in effect "stands in the shoes" of the retail customers for purposes of obtaining wholesale transmission access and new power supply.

retail-turned-wholesale customers for which Order No. 888 provides an opportunity for recovery would not have been incurred but for the action of this Commission in requiring a utility to make unbundled transmission services available. In these cases, the former bundled retail customers of the historical supplying utility (now the bundled retail customers of the new municipal system) would not have obtained access to new power supply but for the Commission's order mandating transmission. Without the regulatory mandate to provide access, the utility would have indirectly continued sales to the same retail customers because the new municipal utility purchasing power on the retail customers' behalf would have had no way to reach other power suppliers. In this situation, there would be no stranded generation costs. In other words, the creation of a municipal utility intermediary to purchase power at wholesale would not, by itself, trigger stranded costs. Rather, it is the access from the historical supplier of the bundled retail customers that is the condition precedent to reaching other power suppliers and thereby triggering stranded costs. Therefore, there is a clear causal nexus between the stranded costs and the availability and use of the tariff required by the Commission.

Costs that are exposed to nonrecovery when a retail customer or a newly-created wholesale power sales customer ceases to purchase power from the utility and does not use the utility's transmission system to reach a new generation supplier (*e.g.*, through self-generation or use of another utility's transmission system) do not meet the definition of "wholesale stranded costs" for which the Rule provides an opportunity for recovery. Such costs are outside the scope of the Rule because such costs would not be stranded as a direct result of the new open access.

In response to the argument that conversion of a customer from retail to wholesale would not simultaneously effectuate a conversion of the costs from retail to wholesale, we believe this argument confuses **[30,405]** the issue. We note that we have defined stranded costs as wholesale or retail on the basis of whether wholesale or retail open access is the cause of the costs being stranded, not on the basis of the original retail or wholesale characteristic of the costs. Thus, even though costs may have been originally incurred as retail-related costs, the precipitating event that results in such costs being stranded in the retail-turned-wholesale customer scenario is the use by the new wholesale customer of the Commission-mandated tariff. When a customer is able to use the Commission-required tariff to reach another generation supplier, it causes the utility to incur an economic cost in providing transmission service that is equal to the foregone revenues that the utility reasonably expected to receive under a state regulatory regime. Thus, because of the causal nexus between the use of a former supplying utility's Commission-mandated transmission tariff and the potential for foregone revenues by that utility as a result of the Commission-required access, the costs stranded by a retail-turned-wholesale customer are properly viewed as economic costs that are jurisdictional to this Commission.

In response to those entities that express concern that the Commission's position on stranded costs associated with retail- turned-wholesale customers invites second-guessing of state commission determinations, we emphasize that we have assumed primary authority to address such costs only in a limited category of cases where there is a direct nexus between the availability of Commission-required open access and the stranding of costs when the former customer uses the

former supplying utility's transmission system (through its open access tariff or a section 211 order) to reach a new supplier. We indicated in Order No. 888 that if the state has permitted any recovery from departing retail-turned-wholesale customers, such amount will not be stranded for purposes of this Rule. We will deduct that amount from the costs for which the utility will be allowed to seek recovery under this Rule from the Commission. In so doing, however, we are not second-guessing the states as to what a utility may recover under state law. Additionally, we will give great weight in our proceedings to a state's view of what might be recoverable.

We also reject the argument that the Commission's position on stranded costs associated with retail-turned-wholesale customers encourages forum shopping. To the contrary, as we said in Order No. 888, to avoid forum shopping and duplicative litigation of the issue, we expect parties to raise claims before this Commission in the first instance. We believe that this Commission should be the primary forum because, without the open access provided by the Rule, the new municipal utility would not be able to reach a new supplier and, as a result, would not cause the utility to incur stranded costs (as defined in this Rule).

We reject as misplaced arguments that the Rule represents a major inconsistency with the Commission's historical promotion of franchise competition between municipalities and utilities and that it will discourage municipalization.[681] It continues to be the Commission's

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[681] In response to VT DPS and Valero, we note that whether or not Otter Tail may have agreed to wheel power for the municipal

policy to encourage competition. Indeed, the goal of Order No. 888 is to remove impediments to competition in the wholesale bulk power marketplace and to bring more efficient, lower cost power to the Nation's electricity consumers. However, the purpose of the stranded cost policy is neither to encourage nor to discourage municipalization, but rather to facilitate a fair transition to competition and to ensure stability in the industry during that transition. As we discuss elsewhere in order, we believe that this Commission must address the recovery of the costs of moving from a monopoly-regulated regime **[30,406]** to one in which all sellers can compete on a fair basis and in which electricity is more competitively priced. On this basis, we believe that if a new wholesale entity such as a municipal utility uses Commission-required open access to reach a new supplier on behalf of its retail customers (previously retail customers of the former supplier), the former supplying utility should be given an opportunity to recover legitimate, prudent and verifiable costs that it incurred under the prior regulatory regime to serve that customer.

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utility that Elbow Lake planned to create if Otter Tail could have made a stranded cost claim against that municipal utility is of no moment to the Commission's decision in Order No. 888 to allow utilities the opportunity to seek recovery of stranded costs associated with retail- turned-wholesale customers. The Court in *Otter Tail* did not address the stranded cost issue because it was not presented in that case. Nor was the Court presented with the extraordinary circumstances -- the historic statutory and regulatory changes, including the requirement of open access, that have converged to fundamentally change the obligations of utilities and the markets in which they operate -- that have justified this Commission's Order No. 888 stranded cost policy.

In response to American Forest & Paper's argument that recovery of 100 percent of stranded costs caused by municipalization is inconsistent with the Commission's policy in the natural gas industry of allowing competitive bypass without imposing transition charges or exit fees on converting customers, we note that industrial gas customers who bypass a local distribution company's (LDC) facilities do not escape transition costs quite so easily as suggested by American Forest & Paper. It is true that, when the end user bypasses the LDC to reach an interstate pipeline different from the pipeline serving the LDC, the Commission views the bypass as a risk of competition from which the LDC should not be shielded.[682] However, when the end user bypasses the LDC to reach the same interstate pipeline that serves the LDC, the Commission may take certain actions to minimize adverse effects on the LDC and its remaining customers.[683] Moreover, an end user that bypasses an LDC to reach the same pipeline that serves the LDC would, in any event, be allocated a share of the pipeline's gas supply realignment costs (if any), since those costs are allocated based on current contract demand (or usage).[684] Accordingly, we see no inconsistency between our

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[682]Texas Gas Transmission Corporation, 65 FERC ¶61,275 (1993).

[683]*Texas Gas Transmission Corporation*, 69 FERC ¶61,245, *reh'g*, 70 FERC ¶61,207 (1995) (requiring pipeline to offer LDC a reduction in its contract demand).

[684]*See Southern Natural Gas Company*, 75 FERC ¶61,046 at p. 61,158 (1996); *Arcadian Corporation v. Southern Natural Gas Company*, 67 FERC ¶61,176 at p. 61,538 (1994). *See also United Distribution Companies*, 88 F.3d at 1181. As the *United*

bypass policy for the natural gas industry and Order No. 888's treatment of stranded costs associated with retail-turned-wholesale customers. Similar to our refusal to shield LDCs from the adverse effects of an end user's bypass to reach a different pipeline than serves the LDC, Order No. 888 does not provide an opportunity for stranded cost recovery where a retail-turned-wholesale customer uses another utility's transmission system to reach a new supplier. As we note above, the opportunity for recovery of stranded costs associated with retail-turned-wholesale customers is limited to those cases in which the former retail customer obtains (either directly or through another wholesale transmission purchaser) unbundled transmission services from its former supplying utility. In the case of an end use customer bypassing the LDC to reach the same pipeline that serves the LDC, the end use customer would similarly be allocated a share of the pipeline's gas supply realignment costs. As a result, American Forest & Paper's attempt to rely on the Commission's gas bypass policy is misplaced.

We also disagree with those entities that argue that the Commission has failed to adequately distinguish Order No. 888's treatment of stranded costs associated with retail-turned-wholesale customers with the Commission's decision in *United Illuminating*. As we stated in Order No. 888, we recognize that we took a different approach to stranded cost recovery associated with retail-turned-wholesale customers in

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Distribution Companies court noted, the Commission has given an LDC relief (and required the bypassing customer to bear its share of transition costs) if the LDC can show a direct nexus between the bypass and the pipeline, although the Commission has declined to adopt a generic rule addressing this issue. 88 F.3d at 1180-81.

United Illuminating, where we suggested that state and local regulatory authorities or the courts should be able to provide an adequate forum to address retail franchise matters, including recovery of stranded costs caused by municipalization, but said we would consider revisiting the question if United Illuminating could demonstrate the lack of a forum.[685] However, we explained that since the issuance of that decision we have had an opportunity to re-analyze the nature of the stranded cost problem when a retail customer **[30,407]** becomes a wholesale customer, including the potential that there might not be a state regulatory forum for recovery of such costs. In these circumstances, we have determined that where such costs are stranded as a direct result of Commission-mandated wholesale transmission access, these costs should be viewed as costs of the transition to competitive wholesale bulk power markets and this Commission should be the primary forum for addressing their recovery.

In response to Nucor's objection that there always is a state forum to address stranded cost recovery associated with retail-turned-wholesale customers, with the adequacy of the relief being a distinct issue, we clarify that our primary concern in retail-turned-wholesale situations is not whether there is an adequate state regulatory forum for the recovery of stranded costs associated with retail-turned-wholesale customers. Rather, our primary concern is that wholesale customers (whether or not formerly retail) should be responsible for the costs incurred to meet their power needs that are stranded when they use the wholesale transmission

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[685]63 FERC at pp. 62,583-84.

ordered by this Commission to reach new suppliers. Our decision to be the primary forum in the case of stranded costs associated with retail-turned-wholesale customers is based on the causal nexus between regulatory- mandated wholesale transmission access and the stranding of costs when a new municipal utility uses such access to obtain new power supply on behalf of retail customers previously served by the former supplying utility.

Rehearing Requests Seeking Expansion of Retail-Turned-Wholesale Jurisdiction

Other entities seek rehearing of the Commission's decision not to be the primary forum for stranded cost recovery in situations in which an existing municipal utility annexes territory served by another utility or otherwise expands its service territory.[686] A number of them argue that the loss of existing retail customers through municipal annexations or expansions is no different from the loss of retail customers through new municipalization because existing municipal systems are likely to use Commission-jurisdictional open access transmission to obtain resources to supply power to the annexed loads.[687] They submit that, just

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[686]*E.g.*, EEI, SoCal Edison, Centerior, Atlantic City, PSE&G, Puget, Public Service Co of CO, Coalition for Economic Competition.

[687]*E.g.*, EEI, SoCal Edison, PSE&G, Puget, Public Service Co of CO, Coalition for Economic Competition. Coalition for Economic Competition suggests, for example, that villages and large industrial customers may opt to join existing municipal systems that, in most cases, will use Commission-jurisdictional

as with newly-municipalized customers, such costs would not be stranded but for the action of this Commission.

Some of these entities express concern that the Rule will encourage retail-turned-wholesale transactions to be undertaken as annexations rather than through the formation of new entities to avoid stranded costs.[688] Public Service Co of CO contends that Order No. 888, in conjunction with the Commission's section 211 order in American Municipal Power Ohio, Inc.,[689] may facilitate municipal annexations by enabling municipal systems to serve new territory through the establishment of second delivery points.

Coalition for Economic Competition and Puget also argue that the Commission must consider stranded costs that arise from municipal expansion in order to satisfy its statutory obligation under the FPA to "set just and reasonable" rates. They contend that there is no justification for charging one rate to former retail customers taking transmission services through a new municipal utility and another rate to those taking service through municipal annexation or through use of another utility's transmission system.

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transmission tariffs to obtain resources to supply power to the annexed loads.

[688] *E.g.*, EEI, Coalition for Economic Competition, Atlantic City, Puget, Public Service Co of CO.

[689] 74 FERC ¶61,086, *final order directing transmission service*, 76 FERC ¶61,265 (1996).

PSE&G suggests that the distinction between new municipalization on the one hand and municipal annexation or expansion on the other hand may lead to unnecessary controversy and litigation as entities wrangle over whether a given expansion/annexation is really an expansion or a municipalization. It says that a situation could arise where a municipality **[30,408]** serves one town in order to serve thousands of additional customers in a second town. According to PSE&G, it is not clear from the Rule whether the Commission would consider this an expansion of a municipality's service territory or a new municipalization.

Puget submits that the stranded cost recovery mechanism must not be subject to being frustrated by simple artifices such as having the new supplier (instead of the departing customer) request and contract for transmission service. SoCal Edison seeks clarification of the Commission's authority to mandate stranded cost recovery if a retail customer disconnects from a utility's system and accesses another generation supplier by interconnecting with a public power entity (who in turn would interconnect with a neighboring jurisdictional utility). It asks the Commission to clarify that such a transaction effectively constitutes a municipalization, not an expansion of a service territory, and that the Commission, under FPA section 211, can compel the recovery of stranded costs by having the "new" jurisdictional utility assess a stranded cost charge and pass the revenues on to the utility from whose system the customer departed.

SoCal Edison seeks several additional clarifications. It states that it understands that the Commission's primary forum status in no way prevents or interferes with a state's authority to order stranded cost recovery from departing retail

customers. If this is not the case, SoCal Edison seeks rehearing on this issue. SoCal Edison also asks the Commission to clarify that the Commission retains the discretion to defer to a state stranded cost calculation methodology if appropriate to do so on the facts of a particular case.

Commission Conclusion

We have carefully reviewed the arguments made by petitioners seeking rehearing of our decision not to be the primary forum for stranded cost recovery in the case of municipal annexations. Based on that review we have decided to reconsider our decision. This conclusion is based in large part upon the very significant similarities between the creation of a *new* municipal utility system (also referred to as municipalization) and the expansion of an *existing* municipal utility system (*e.g.*, through annexation of additional retail service territory). We recognize that the *same nexus* to Commission-required transmission access that forms the basis for our decision to allow a utility to seek stranded cost recovery in cases of new municipalization -- use of the former supplying utility's transmission system -- is likely to be present in some cases of municipal annexation. In the case of both new municipalizations and annexations, the bundled retail customers of a local utility become the bundled retail customers of a municipal utility (in one case a new municipal utility, in the other an existing municipal utility) that *will use the transmission system of the retail customers' former supplier in order to access other suppliers.*

As we explain above, in a "retail-turned-wholesale customer" situation, such as the creation of a municipal utility

system, a Docket Nos. RM95-8-001 and RM94-7-002 newly-created entity becomes a wholesale power purchaser on behalf of the retail customers. It is the conduit by which retail customers, if they cannot obtain direct retail access, can reach power suppliers other than their historical local utility power supplier. Although the retail customers remain bundled retail customers, in that they become the bundled customers of the new entity, we call this a "retail-turned-wholesale customer" situation because the new entity in effect "stands in the shoes" of the retail customers for purposes of obtaining wholesale transmission access and new power supply. The same analogy applies to newly-annexed customers; they become "new" wholesale customers in the sense that the wholesale entity obtains transmission and new power supply on their behalf.

Accordingly, we clarify that this Commission will be the primary forum for addressing the recovery of stranded costs if an existing municipal utility uses the transmission system of its annexed retail customers' former supplier to access new suppliers to serve the annexed load. As long as Commission-required transmission access (the former supplier's open access tariff or transmission services ordered under FPA section 211) is the vehicle that enables an existing municipal utility to obtain power supplies to serve annexed loads, we believe that any costs stranded as a result of this wholesale transmission access are properly viewed as economic costs that are jurisdictional to this Commission. **[30,409]** In such a case, the bundled retail customers that are annexed by an existing municipal utility would, through the municipal utility, use the transmission system of their former supplier to obtain access to new supplies and thereby expose their former supplier to non-recovery of prudently incurred costs. As in the case of new municipal systems that use the

transmission system of their retail customers' former supplier, such costs would not be stranded *but for* the action of this Commission in requiring a utility to make unbundled transmission services available.[690]

Just as we will not be the primary forum for stranded cost recovery for all new municipalizations, so also we will not be the primary forum for stranded cost recovery for *all* cases of municipal annexation. Instead, our holding is limited to those cases in which the existing municipal system uses Commission-mandated transmission access from the annexed customers' former supplying utility to obtain power from a new supplier. Costs that are exposed to nonrecovery when an existing municipal utility does not use the transmission system of the retail customers' former supplier to reach a new generation supplier (*e.g.*, through self-generation or use of another utility's transmission system) do not meet the

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[690]SoCal Edison requests clarification that a transaction in which a retail customer disconnects from a utility's system and accesses another generation supplier by interconnecting with a public power entity, who in turn would interconnect with a neighboring jurisdictional utility, constitutes a municipalization, not an expansion of a service territory. Because we have decided to treat municipal annexations (or expansions) and new municipalizations similarly for purposes of stranded cost recovery under the Rule, SoCal Edison's request is moot to the extent that it envisions a scenario in which the former supplier's transmission system is used to access a new generation supplier. However, as discussed below, the Rule would not provide an opportunity to seek recovery of stranded costs if the municipal entity in the scenario described by SoCal Edison *does not* use the former supplier's transmission system.

definition of "wholesale stranded costs" for which the Rule provides an opportunity for recovery. Such costs are outside the scope of the Rule because such costs would not be stranded as a direct result of Commission-required transmission access.

We reject as misplaced the argument that the Commission, by failing to address costs that arise if a municipal utility (whether a new municipal utility or an existing municipal utility that annexes additional retail customer territory) does not use the historical supplying utility's transmission system, has not met its statutory obligation to "set just and reasonable" rates. The Commission in this rulemaking has not determined any utility's just and reasonable rates. Further, Order No. 888 does not by its terms bar the recovery of costs that do not result from the use of Commission-required transmission access. Utilities may, as before, seek recovery of such non-open access-related costs on a case-by-case basis in individual rate proceedings. The Commission will not prejudge those issues here.

As we indicated in Order No. 888 we also are concerned that there may be circumstances in which customers and/or utilities could attempt, through indirect use of open access transmission, to circumvent the ability of any regulatory commission -- either this Commission or state commissions -- to address recovery of stranded costs.[691] We reiterate that we reserve the right to address such situations on a case-by-case basis.

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[691] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,819; *mimeo* at pp. 536-37.

We share the concern expressed by Puget that a retail-turned-wholesale customer should not be allowed to avoid any stranded cost obligation that it may have under Order No. 888 simply by having its new supplier be the entity that requests and contracts for transmission service from the former supplying utility. We clarify that the opportunity for recovery of stranded costs associated with retail-turned-wholesale customers under Order No. 888 applies if the transmission system of the former supplier is used to transmit the newly obtained power supplies to the departing retail customer, regardless of whether the customer or its new supplier is the actual entity that requests and contracts for the unbundled transmission service. We have revised the definition of "wholesale stranded cost" in section 35.26(b)(1)(ii) accordingly to include **[30,410]** the situation in which the retail customer subsequently becomes, either directly or through another wholesale transmission purchaser, an unbundled wholesale transmission services customer of the former supplying utility.

We clarify in response to SoCal Edison's request that our decision to be the primary forum for recovery of stranded costs from retail-turned-wholesale customers is not intended to prevent or to interfere with the authority of a state to permit any recovery from departing retail customers, such as by imposing an exit fee prior to creating the wholesale entity. As we indicated in Order No. 888, if the state has permitted any such recovery from a departing retail-turned-wholesale customer, that amount will not in fact be stranded. Accordingly, we will deduct that amount from the costs for

which the utility will be allowed to seek recovery from this Commission.[692]

We clarify in response to SoCal Edison's request that the Commission has the discretion to defer to a state stranded cost calculation methodology. However, because we recognize that state retail access plans may present questions that need to be addressed on a case-by-case basis, we will consider whether to exercise that discretion on a case-by-case basis.

7. Recovery of Stranded Costs Caused by Retail Wheeling

In Order No. 888, we concluded that both this Commission and the states have the legal authority to address stranded costs that result when retail customers obtain retail wheeling in order to reach a different generation supplier, and that utilities are entitled, from both a legal and a policy perspective, to an opportunity to recover all of their prudently incurred costs.[693] We explained that this Commission's authority to address retail stranded costs (i.e., stranded costs associated with retail wheeling customers) is based on our jurisdiction over the rates, terms, and conditions of unbundled retail transmission in interstate commerce by public utilities, and that the authority of state commissions to address retail stranded costs is based on their jurisdiction over local

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[692] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,819; *mimeo* at p. 537

[693] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,824-26; *mimeo* at pp. 553-58.

distribution facilities and the service of delivering electric energy to end users. Because it is a state decision to permit or to require the retail wheeling that causes stranded costs to occur, we decided we generally will leave it to state regulatory authorities to deal with any stranded costs occasioned by retail wheeling. The only circumstance in which we will entertain requests to recover stranded costs caused by retail wheeling is when the state regulatory authority[694] does not have authority under state law to address stranded costs when the retail wheeling is required. In such a case, we will permit a utility to seek a customer- specific surcharge to be added to an unbundled transmission rate.

We noted that most states have a number of mechanisms for addressing stranded costs caused by retail wheeling. We indicated that rates for services using facilities used in local distribution to make a retail sale are state-jurisdictional, and that states will be free to impose stranded costs caused retail wheeling on facilities or services used in local distribution. We also said that states may use their jurisdiction over local distribution facilities or services to recover so-called stranded benefits.

We stated that we believe our approach to stranded costs associated with retail wheeling customers represents an

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[694] "State regulatory authority" has the same meaning as provided in section 3(21) of the FPA: 'State regulatory authority' has the same meaning as the term 'State commission', except that in the case of an electric utility with respect to which the Tennessee Valley Authority has ratemaking authority (as defined in section 3 of the Public Utility Regulatory Policies Act of 1978), such term means the Tennessee Valley Authority.

appropriate balance between federal and state interests that ensures that the rates for transmission in interstate commerce by public utilities (except in a narrow circumstance) will not be burdened by retail costs.

We expressed concern about the cost-shifting potential in a holding company or other multi-state situation, where denial **[30,411]** of retail stranded cost recovery by a state regulatory authority could, through operation of the reserve equalization formula in a Commission-jurisdictional intra-system agreement, inappropriately shift the disallowed costs to affiliated operating companies in other states. We said that we will deal with such situations if they arise pursuant to public utility filings under section 205 or complaints under section 206. Thus, the need to amend a jurisdictional agreement to prevent stranded costs associated with retail wheeling customers from being shifted to customers in other states will be addressed on a case-by-case basis. We encouraged the affected state commissions in such situations to seek a mutually agreeable approach to this potential problem. If such a consensus solution resulted in a filing to modify a jurisdictional agreement, we indicated that we would accord such a proposal deference, particularly if other interested parties support the filing. In the event that the state commissions and other interested parties cannot reach consensus that would prevent cost shifting, we said that the Commission would ultimately have to resolve the appropriate treatment of such stranded costs.

Rehearing Requests Opposing Any Commission Involvement in Stranded Costs Associated With Retail Wheeling Customers

A number of entities dispute the Commission's statement that both it and the states have the legal authority to address stranded costs that result from retail wheeling. Central Illinois Light contends that the Commission's claim of dual jurisdiction is inconsistent with *FPC v. Southern California Edison Company*.[695] It says that the court in that case recognized that Congress meant to draw a bright line easily ascertained between state and federal jurisdiction, making unnecessary case-by-case analysis. Central Illinois Light asserts that the Commission has stepped over the bright line into the states' exclusive jurisdiction over retail rates.

IA Com seeks rehearing of the Commission's assertion of concurrent jurisdiction with state authorities over stranded costs associated with retail wheeling customers on the ground that it is based on the Commission's erroneous assertion of jurisdiction over unbundled retail transmission.

IL Com says that regardless of whether the Commission's claim of jurisdiction over retail transmission is upheld, the Commission's ruling that there is joint jurisdiction over retail stranded costs is in error. According to IL Com, the Commission has no authority over such stranded costs. IL Com also disputes the Commission's characterization of the derivation of state authority to address such stranded costs. It says that state commission authority does not derive only from states' jurisdiction over local distribution facilities and the

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[695] 376 U.S. 205, 215-16 (1964).

service of delivering electric energy to end users. IL Com submits that state commission authority to address retail stranded costs derives from the existence of state commission jurisdiction over the facilities and costs at the time of their incurrence.

A number of entities contend that Commission jurisdiction over transmission facilities used in interstate commerce does not give it jurisdiction over stranded investment in retail generating assets.[696] Several argue that the fact that a retail wheeling customer might need transmission access from its former supplier does not change the character of the costs that are stranded. They maintain that retail stranded costs are not costs of providing unbundled transmission service, but are costs associated with providing what was formerly bundled retail service, over which the Commission has no jurisdiction.[697]

Several entities argue that it is solely the action of the state that allows a given **[30,412]** utility's retail customers to

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[696] *E.g.*, Central Illinois Light, IN Consumer Counselor, IN Consumers, Nucor, FL Com, WI Com, VA Com, AR Com, MO/KS Com, OH Com, APPA. For example, FL Com asserts that costs for facilities that are currently under the jurisdiction of state authorities do not become the Commission's jurisdiction because retail wheeling is instituted; in most cases, the states approved both the construction and the cost recovery for these facilities under bundled rate structures. FL Com submits that the states are in a better position to judge the extent and value of assets that may become stranded as a result of retail wheeling.

[697] *E.g.*, APPA, AR Com, MO/KS Coms, OH Com.

seek alternative sources of supply; therefore, there is no nexus between the Commission's wholesale transmission rule and any costs that might be stranded by a state-established customer choice regime.[698]

A number of entities submit that the provision of FPA section 201 that federal regulation is "to extend only to those matters which are not subject to regulation by the States" bars any attempt by the Commission to displace or supplant an admittedly legitimate exercise of state authority over retail stranded costs.[699] NASUCA submits that all state commissions have the authority to establish just and reasonable rates for the retail electric utilities in their respective jurisdictions.[700] It maintains that only state regulators are in a position to rule on the treatment of costs that were allowed in retail rates pursuant to state laws; the Commission has no knowledge or expertise regarding the specific state legal frameworks in

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[698]*E.g.*, NARUC, TAPS.

[699]*E.g.*, NASUCA, NY Com, WY Com, NARUC. The Consumer's Utility Counsel Division of the Georgia Governor's Office of Consumer Affairs filed comments on June 24, 1996, in support of NARUC's request for rehearing on the jurisdictional issues pertaining to the recovery of retail stranded costs. While answers to requests for rehearing generally are not permitted, 18 CFR §385.213(a)(2) (1996), we will depart from our general rule because of the significant nature of this proceeding and will accept these comments.

[700]According to NASUCA, whether or not that authority includes a requirement that a utility receive 100 percent return on stranded costs (or something less) is a matter to be determined by the state courts and legislatures.

which these costs were included in rates. NY Com argues that the Commission does not have jurisdiction to determine the rate treatment of costs devoted to retail service and, thus, lacks authority to allow recovery if a state decides not to do so.

VA Com argues that section 201(b)(1) of the FPA restricts the Commission's jurisdiction to wholesale sales. It says that a departing retail customer remains a retail customer, regardless of the supplier. VA Com concludes that no portion of the transaction is a wholesale sale, and that there are no wholesale costs associated with a retail wheeling transaction.[701]

A number of entities seek rehearing of the Commission's decision that it will entertain stranded cost claims when the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is[702] NARUC submits that Congress did not intend the Commission to become involved in adjudicating legal questions regarding the breadth of state law authority granted state commissions by their legislatures. NARUC expresses concern that the Commission would second-guess a state cost recovery determination and promote forum shopping. Once a balance has been struck at the state level

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[701] *See also* AR Com (one retail transaction is replaced by another retail transaction; there is no wholesale transaction and no wholesale costs over which the Commission has jurisdiction).

[702] *E.g.*, NARUC, Central Illinois Light, IN Com, American Forest & Paper, IN Consumer Counselor, IN Consumers, IL Com.

concerning the terms of restructuring, NARUC submits that it is inconceivable that the Commission would have either the desire or authority to second-guess a state's legislative and regulatory processes.

Several entities object that the Commission effectively would authorize recovery of stranded costs associated with a retail wheeling customer if a state legislature withholds from the state regulatory agency the authority to approve stranded cost recovery.[703] They submit that just because a state has not given its regulatory commission the authority to impose stranded costs in the case of retail wheeling does not confer jurisdiction on the Commission to impose such charges. They contend that the state legislature should be the final arbiter of state policy. IL Com submits that if a state legislature chooses not to give its state commission the authority to act on stranded costs, "that can be taken as a clear indication that the state's legislature most certainly does not want FERC to address them."[704] Central Illinois Light objects that the Commission has offered no reason why it will accept the decision of the **[30,413]** regulatory agency, but not that of the legislature.

AMP-Ohio and Cleveland ask the Commission to clarify that its deference to the determinations of the states is to the authority of the states as exercised through state

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[703] *E.g.*, Central Illinois Light, IN Com, American Forest & Paper, IN Consumer Counselor, IN Consumers, IL Com. TX Com considers that it has the power to address stranded cost issues related to retail transmission service.

[704] IL Com at p. 38 (emphasis in original).

legislative bodies (and other political subdivisions with legislative authority) as well as to state regulatory bodies. They submit that if the state legislature, or a local government acting in accordance with its authority, enacts retail wheeling legislation that expressly limits the ability of its regulatory body to permit recovery of stranded costs, even barring all such recovery, the Commission should not become involved.

Several entities ask the Commission to clarify that Order No. 888 does not permit utilities to apply to the Commission for recovery of stranded costs associated with a retail wheeling customer when a state regulatory authority has "addressed" a request for the same stranded costs but has not allowed 100 percent recovery.[705] ELCON gives two hypothetical examples to which it asks the Commission to respond: one where a state regulatory authority possesses full stranded cost recovery authority but allows only 50 percent recovery; the other where the state legislature provides the state regulatory authority by statute with the power to permit recovery of up to 50 percent of identified stranded costs.

Commission Conclusion

We reaffirm our conclusion that both this Commission and the states have the legal authority to address stranded costs that result when retail customers obtain retail wheeling in interstate commerce from public utilities in order to reach a different generation supplier, but that, because it is a state decision to permit or require the retail wheeling that causes retail stranded costs to occur, we will leave it to state

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[705] *E.g.*, ELCON, NASUCA, IL Com, NY Com.

regulatory authorities to deal with any stranded costs occasioned by retail wheeling. The only circumstance in which we will entertain requests to recover stranded costs caused by retail wheeling is when the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required.

We will reject the requests for rehearing that oppose any Commission involvement in stranded costs associated with retail wheeling customers. We disagree with those entities that challenge our conclusion that both this Commission and the states have the legal authority to address stranded costs that result from retail wheeling (variously described by those entities as dual, concurrent, or joint jurisdiction). The Commission explained in detail in Order No. 888 the legal basis for concluding that this Commission and the state commissions each have jurisdiction over separate aspects of a retail wheeling transaction.[706] This Commission has jurisdiction over the rates, terms, and conditions of unbundled retail transmission in interstate commerce by public utilities. State commissions have jurisdiction over local distribution facilities and the service of delivering electric energy to end users. Based on our respective jurisdictions over separate aspects of the retail wheeling transaction, we believe either has the authority to provide the former supplying utility with an opportunity to recover costs stranded when the departing customer uses retail transmission in interstate commerce to reach a new supplier, but that here,

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[706] *See FERC Statutes and Regulations, Reulations Preambles January 1991-June 1996* at pp. 31,780-85; *mimeo* at pp. 427-42 and Appendix G.

unlike the retail-turned-wholesale scenario, the state commission should be the primary forum because these costs are stranded by the action of the state. We would act only if the primary forum is not available. We have made a policy decision that this Commission will step in to fill a regulatory "gap" that could result in no effective forum under which utilities would have an opportunity to seek recovery of prudently incurred costs.

Several entities argue that the Commission does not have jurisdiction over stranded investment in retail generating assets, that use of Commission-jurisdictional transmission does not change the character of the costs that are stranded, that stranded costs associated with retail wheeling customers are not costs of providing unbundled transmission service, **[30, 414]** but are costs associated with providing what was formerly bundled retail service, and that only state regulators are in a position to rule on the treatment of costs that were allowed in retail rates pursuant to state laws. While we agree that stranded costs associated with retail wheeling are costs that are retail in character in the sense that they are in retail bundled rates and become stranded as a result of retail wheeling required by the state commission, we do not believe this precludes the Commission from exercising jurisdiction in the limited circumstances of the Rule.

As an initial matter, we note that there are rarely separate retail and wholesale generating facilities. Retail customers and wholesale requirements customers get energy from the same facilities, each buying a "slice of the system." Typically all generating assets go into both the retail and the wholesale rate bases for determining retail and wholesale rates. Rates are determined by allocating the total generating

costs among customer classes. The parties confuse the issue before us to the extent they suggest that state commissions, not this Commission, have "jurisdiction" over certain "costs." Neither the state commissions nor this Commission has exclusive jurisdiction over "costs." Each regulatory authority has jurisdiction to determine "rates" for services subject to its jurisdiction and, in determining rates, may take into account all of the costs incurred by the utility. Under historical cost-of-service ratemaking, each regulatory authority, in exercising its respective *ratemaking* jurisdiction, reviews the *total* costs incurred by a utility to provide service and makes its separate and independent determination of what costs may be recovered through rates within its jurisdiction.[707] Generating

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[707] If a utility is regulated by both this Commission and a state commission, each commission, in setting cost-of- service rates within its jurisdiction, will separately and independently determine the utility's total cost of providing service (also known as the utility's total revenue requirement). This will be based on the expenses incurred in providing service and a reasonable profit on the utility's assets that are used to provide the service. The commissions may differ as to what assets are appropriately included in total rate base, what other costs are appropriately included in the total cost of service, and what rate of return should be permitted. Once each regulatory authority has determined the appropriate total revenue requirement, it then will determine what portion of that total revenue requirement should be borne by the utility's wholesale customers and what share should be borne by retail customers (also called cost allocation). Each commission may also reach different conclusions on this split as well. Thus, under historical cost-based ratemaking, regulatory authorities do not carve out so-called "wholesale costs" that only this Commission can take into account in determining rates subject to its jurisdiction or so-called "retail costs" that only a state commission can take into account in

costs continually shift between retail and wholesale rates over time.[708]

More importantly, both the state commission and this Commission have a responsibility to oversee the financial health of the utilities we regulate. Each has jurisdiction to make judgments about recovery of the costs of the assets in the utility's total rate base. Utilities are entitled to a regulatory forum that can adjudicate claims that they are or are not entitled to recovery of costs incurred regardless of the initial retail or wholesale "character" of those costs, and we believe we have the authority and obligation to fill a regulatory "gap" that could occur.[709]

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determining rates subject to state jurisdiction. Additionally, this Commission and state commissions have the discretion to determine whether costs are appropriately recovered through a transmission, generation, or distribution component of a rate (also called functionalization of costs) within their respective jurisdictions.

[708]We reject arguments that stranded retail generation costs are not a cost of providing unbundled retail transmission. While such costs are not a cost of operating the physical transmission system, nevertheless, they are an economic cost incurred as a result of being required to provide retail transmission.

[709]This is not a regulatory "gap" in the sense that the Commission would be asserting authority over matters not within its jurisdiction. However, the Commission would be filling a regulatory "gap" to the extent that the utility normally would have the opportunity to seek approval from its state regulatory commission to recover costs in retail rates from a departing retail customer or to reallocate those costs to other retail customers. In circumstances where the utility does not have this opportunity

[30,415]

In response to the argument that it is solely the action of the state that allows a retail customer to seek alternative sources of supply and, as a result, there is no nexus between the Commission's wholesale transmission rule and any costs that might be stranded by a state-established customer choice regime, we agree. Indeed, as we indicate in Order No. 888, we decided to leave it to state regulatory authorities to deal with any stranded costs occasioned by retail wheeling (with a limited exception) because it is a state decision to permit or require the retail wheeling in the first instance that causes retail stranded costs to occur. Our determination, as explained above, is to fill any regulatory gap that arises as a result of interstate wheeling. We believe that it is necessary for the Commission to act as a backstop in this limited instance to ensure that costs stranded as a result of retail wheeling do not go unrecovered because the state regulatory authority lacks the authority under state law to address such costs. At the same time, as we stated in Order No. 888, we believe that most states have a number of mechanisms for addressing stranded costs caused by retail wheeling. We emphasize that this Rule is not intended to preempt the exercise of any existing state authority with respect to the assessment of a stranded cost or stranded benefits charge on a retail customer that obtains retail wheeling.

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because the state regulatory authority has no authority to address the issue, we may appropriately fill this regulatory "gap" to permit recovery from the departing customer through the retail transmission rate.

In response to arguments that the Commission's decision will result in second-guessing or interfering with a state's legislative processes and decisions, we believe these arguments are premature. As a general matter, we do not expect that our decision to be a backstop will interfere with legislative decisions that specifically address stranded cost matters and the scope of the state regulatory authority's authority in determining stranded costs. If states or parties to a retail stranded cost recovery case brought before this Commission believe that a Commission decision on the issue would interfere with state legislative decisions, they should raise their arguments, and support therefor, at that time.

We clarify that Order No. 888 does not permit utilities to seek recovery from the Commission of stranded costs associated with retail wheeling customers if a state regulatory authority with authority to address retail wheeling stranded costs has in fact addressed such costs, regardless of whether the state regulatory authority has allowed full recovery, partial recovery, or no recovery.

Rehearing Requests Supporting Broader Jurisdiction Over Stranded Costs Associated With Retail Wheeling Customers

A number of entities seek rehearing of the Commission's decision not to serve as a backstop for all stranded costs associated with retail wheeling customers. Some assert that the Commission has the legal authority to address independently stranded costs that arise from retail wheeling and that the Commission cannot lawfully abdicate or

delegate such authority to the states.[710] Coalition for Economic Competition submits that the Commission correctly concluded that it has jurisdiction over retail transmission rates, terms and conditions and the authority to address retail wheeling stranded costs. Thus, it argues that the Commission is without the power to make a "policy determination" that results in the Commission not exercising its legal authority over stranded costs associated with retail wheeling customers. It asserts that, just as the Commission recognizes that it "cannot simply turn over its jurisdiction" to the states to determine facilities subject to Commission jurisdiction,[711] the Commission cannot turn over its jurisdiction to establish stranded cost charges that it correctly determined it has the authority to establish. Coalition for Economic Competition argues that the Commission should adopt a stranded cost recovery policy similar to the policy the Commission has adopted with respect to the determination of state/federal jurisdiction, whereby the Commission would defer to state stranded cost determinations so long as they are consistent with the Commission's policy.

[30,416]

Utilities For Improved Transition argues that the Commission's authority over public utility rates for the transmission of electric power, both wholesale and retail, is plenary and exclusive. As a result, it submits that the Commission may not avoid responsibility for costs stranded

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[710] *E.g.*, Utilities For Improved Transition, Coalition for Economic Competition.

[711] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,784; *mimeo* at p. 439.

by transmission of retail power.[712] Illinois Power contends that Congress did not authorize the Commission to reject jurisdictional rate filings whenever the Commission regards the state commissions as a more convenient or appropriate forum.

EEI and the Coalition for Economic Competition contend that virtually all retail stranded costs can only occur through the vehicle of Commission-jurisdictional transmission in interstate commerce. They submit that the Commission, having recognized the clear nexus between FERC-jurisdictional transmission and stranded costs in the retail-turned-wholesale context, cannot fail to recognize the same clear nexus in the retail wheeling context.

Utilities For Improved Transition says that it is legally immaterial whether stranded costs are caused by the Commission's ordering the transmission or the states' doing so; the determining factor is who has the jurisdiction to make the rates for the service, not who has the jurisdiction to order the service.

Coalition for Economic Competition and Utilities For Improved Transition contend that the Commission must

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[712]Utilities For Improved Transition argues that, based on *Consolidated Edison Company of New York, Inc.*, 15 FERC ¶61,174 at p. 61,405 (1981) and other cases, the Commission has jurisdiction over the entire delivery service (rendered on both the transmission and local distribution facilities) as a transmission transaction. Utilities For Improved Transition submits that states do not have authority over rates on local distribution facilities used to complete a transmission transaction.

consider stranded costs that arise from retail wheeling in order to satisfy its statutory obligation under the FPA to "set just and reasonable" rates. Coalition for Economic Competition maintains that FPA sections 201, 205 and 206 do not give the Commission the flexibility to allow stranded costs in certain jurisdictional wheeling rates (e.g., wholesale wheeling and new municipalizations) but to exclude them from other jurisdictional wheeling rates (e.g., retail wheeling, municipal annexation, and bypass).[713] Utilities For Improved Transition says that the just and reasonable standard requires the Commission to backstop the states to ensure that there is full stranded cost recovery. It objects that Order No. 888's disposition of jurisdiction creates a problem of cross-class discrimination (wholesale versus retail) and inter-class discrimination (some retail versus the remainder of the retail).

Coalition for Economic Competition further argues that the Commission's failure to address all stranded costs associated with retail wheeling customers will result in an improper taking under the Constitution.[714] It also argues that the Commission is not permitted to disregard its findings in Order No. 888 which, according to Coalition for Economic Competition, "inexorably" lead to the conclusion that Commission action on "all" stranded costs (including retail

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[713]EEI states that the Commission did not rebut EEI's argument that the Commission's failure to address all retail stranded costs was unduly discriminatory.

[714]In support of its argument, Coalition for Economic Competition cites *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 602 (1944); *Duquesne Light Company v. Barasch*, 488 U.S 299, 307-08 (1989).

wheeling, municipal annexation, and bypass stranded costs) is required.[715]

Illinois Power argues that the FPA does not authorize the Commission to discriminate among utilities based on the state of their residence, and that the Commission must allow all utilities to seek interstate rate recovery of just and reasonable retail stranded costs. Illinois Power asserts that the Rule will lead to the absurd, unduly discriminatory result that utilities located in states whose legislatures have failed to provide for stranded cost recovery will be better off than those located in states that provide for only limited stranded cost recovery. It supports use of the Commission's statutory authority to establish a uniform, national method for retail stranded cost recovery.

Coalition for Economic Competition also contends that the Commission's decision **[30,417]** to let the states deal with retail stranded costs is arbitrary and capricious because the Commission failed to consider the arguments that stranded cost opponents will make before state commissions, such as that a state lacks jurisdiction to impose stranded cost charges or that the state imposition of such charges may be preempted or found to be an undue burden on interstate commerce. It further argues that the Commission's reliance on state jurisdiction over the service of delivering electric energy to the end user does not reflect reasoned decisionmaking. It submits that the Commission has failed to consider that the sale of electric energy may take place outside of the state into which the energy is transmitted, in which case the state

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[715]Coalition for Economic Competition at p. 14.

commission may have no jurisdiction over either the sale or the transmission of the energy and, accordingly, no authority to consider stranded costs.

A number of entities ask the Commission to act on requests for retail stranded cost recovery when the state commission lacks authority or has authority to order recovery, but has declined to do so or has only allowed partial recovery.[716]

Lastly, TX Com notes that section 35.26(d) (dealing with recovery of retail stranded costs) refers only to public utilities. It suggests that the omission of a reference to transmitting utilities appears to be inadvertent and should be corrected.

Commission Conclusion

The Commission will reject the requests for rehearing of our decision not to assume a backstop role for all stranded costs associated with retail wheeling customers. We explained in Order No. 888 that commenters that describe our action as an unlawful abdication or delegation of authority misconstrue the nature of our decision to leave stranded costs associated with retail wheeling customers (with a limited exception) to state regulatory authorities.[717] We have not "abdicated" or

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[716]*E.g.*, Centerior, Southern, SoCal Edison.

[717]We also explained that the case law they cite (which they refer to again in their rehearing requests) to support the proposition that an agency is not authorized to abdicate its statutory responsibility or to delegate to parties and intervenors regulatory

"delegated" to state regulatory authorities our jurisdiction over the rates, terms, and conditions of retail transmission in interstate commerce; if retail transmission in interstate commerce by a public utility occurs, public utilities offering such transmission must comply with the FPA by filing proposed rate schedules under section 205.[718] Instead, we have made a policy determination that the recovery of stranded costs associated with retail wheeling customers -- an issue over which either this Commission or state commissions could exercise authority by virtue of their jurisdiction over retail transmission in interstate commerce and over local distribution facilities and services, respectively -- is primarily a matter of local or state concern for which the primary forum

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responsibilities is factually distinguishable and inapposite. *See FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,825 and note 765; *mimeo* at pp. 554-55 and note 765.

[718]The entities who argue that the Commission has abdicated or delegated its jurisdiction to the states misconstrue the Commission's jurisdiction to determine rates for unbundled transmission in interstate commerce as somehow including exclusive "jurisdiction" over "costs." However, as discussed above, neither this Commission nor the state commissions has exclusive "jurisdiction" over "costs." Rather, each has jurisdiction to determine "rates" for services subject to its jurisdiction. It is in the course of determining "rates" for unbundled transmission in interstate commerce that this Commission can take into account various costs incurred by a utility to provide jurisdictional service. A state commission can take those same costs into account in making its separate and independent determinations of what costs may be recovered through rates within its jurisdiction. See note 707, supra, and accompanying text.

should be the state commissions. However, if the state regulatory authority does not have authority under state law to be the forum to address stranded costs when the retail wheeling is required, then we will entertain requests to recover such costs. As we explain above in response to the rehearing petitioners that oppose any Commission involvement in stranded costs associated with retail wheeling customers, we have made a policy decision that this Commission will step in to fill a regulatory "gap" that could result in no effective forum under which utilities would have an opportunity **[30,418]** to seek recovery of prudently incurred costs.[719]

We disagree with Coalition for Economic Competition's argument that our findings in Order No. 888 "inexorably" lead to the conclusion that Commission action on "all" stranded costs (including retail wheeling and bypass stranded costs) is required, much less that the Commission has ignored the findings in Order No. 888. To the contrary, as we explain in Section IV.J.1, it is not the purpose of this Rule to allow utilities an opportunity to seek to recover "all" uneconomic costs that might be stranded when a customer leaves its utility supplier. We have fully explained our reasons for adopting an approach that, for purposes of stranded cost recovery from wholesale transmission customers, relies on the nexus between stranded costs and the use of transmission tariffs required by this Commission and, for purposes of

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[719]Based on these same considerations, we reject Coalition for Economic Competition's request that the Commission assume a backstop role for all stranded costs associated with retail wheeling customers but defer to state stranded cost determinations so long as they are consistent with the Commission's policy.

stranded cost recovery from retail customers, recognizes state commission jurisdiction but fills potential regulatory gaps that could arise in the transition to new market structures.

We disagree with those entities that contend that the Commission must consider retail stranded costs in order to satisfy our statutory obligation under the FPA to set just and reasonable rates. In determining just and reasonable rates for jurisdictional transmission service, which currently are determined on a cost basis, the Commission satisfies its statutory obligation under the FPA by allowing utilities an opportunity to recover their prudently incurred costs plus a reasonable rate of return. As we have explained above, this may include the costs of use of the physical transmission system, as well as economic costs incurred by the utility when it provides Docket Nos. RM95-8-001 -92- and RM94-7-002 transmission service (e.g., stranded costs). However, in situations in which a state regulatory authority has the authority to address recovery of retail stranded costs, there is no regulatory "gap," and there is no obligation for this Commission to provide a second opportunity for recovery.[720]

We reject arguments that FPA sections 201, 205 and 206 do not give the Commission the flexibility to allow stranded costs in certain jurisdictional wheeling rates (wholesale wheeling and new municipalizations) but to

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[720]If the state regulatory authority is the forum before which to seek recovery, the utility may make whatever arguments it wishes regarding the justness and reasonableness of its rates, as well as any unconstitutional taking arguments it may have, before the state forum. Further, it can pursue appeals of unfavorable decisions through the state court system.

exclude them from other jurisdictional wheeling rates (retail wheeling in interstate commerce and use of another utility's transmission tariff), and that this policy somehow makes rates discriminatory. Recovery of this type of cost through a transmission rate is obviously not the norm, but is necessitated by the need to deal with the transition costs associated with this Rule. As discussed in detail in the Rule, the Commission has carefully balanced the interests of utilities as well as customers in concluding that the opportunity for stranded cost recovery through transmission rates should be permitted in only two general circumstances: (1) in the case of wholesale stranded costs, where there is a direct nexus to Commission-required transmission access; and (2) in the case of retail stranded costs, where there otherwise would be a regulatory gap because a state regulatory authority lacks authority under state law to address stranded costs at the time that retail wheeling is required. We see nothing in the FPA that precludes us from exercising this flexibility and, indeed, the parties have not pointed to anything that, in our opinion, precludes us from exercising this discretion.

We reject the argument that virtually all stranded costs associated with retail wheeling customers can occur only through the vehicle of Commission-jurisdictional transmission in interstate commerce, and therefore, that the same nexus between FERC-jurisdictional transmission and stranded costs that exists in the retail-turned-wholesale context is present in the retail wheeling context. We also **[30,419]** disagree that it is legally immaterial whether stranded costs are caused by the Commission's ordering the transmission or the states doing so, and that the determining factor is who has the jurisdiction to make the rates for the service, not who has the jurisdiction to order the service. The opportunity for stranded cost

recovery set forth in this Rule is based on the causal link between stranded costs and the availability and use of the Commission-required transmission tariff. It is true that in both the retail-turned-wholesale context and the retail wheeling context there is a limited nexus between stranded costs and Commission-jurisdictional access since, in both situations, the Commission has jurisdiction over the rates, terms and conditions of the transmission service and, therefore, the authority to permit stranded cost recovery through the transmission rates. However, the causal nexus to FERC-jurisdictional transmission and stranded costs in the two contexts (retail vs. retail-turned-wholesale) is different. In the retail wheeling context, there is no causal nexus between stranded costs and transmission that has been ordered by this Commission. In the retail-turned-wholesale context, in contrast, the opportunity for a utility to seek recovery of stranded costs is grounded on the existence of a direct causal nexus between stranded costs and transmission that has been *ordered by this Commission.*

We will reject the rehearing petitions that ask the Commission to act on requests for stranded cost recovery associated with retail wheeling customers not only when the state commission lacks authority, but also when the state commission has authority but either has declined to use it or has only allowed partial recovery. As explained above, our decision to entertain requests to recover stranded costs caused by retail wheeling in a limited circumstance (when the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required) is based on our determination to fill any regulatory gap that arises in association with interstate transmission.

We will reject TX Com's request that the Commission clarify that section 35.26(d) (dealing with recovery of retail stranded costs), which refers only to public utilities, should also refer to transmitting utilities. The Commission's decision to act as a limited backstop in the case of stranded costs associated with retail wheeling customers is based on our jurisdiction under sections 205 and 206 of the FPA over the rates, terms, and conditions of retail transmission in interstate commerce. As a result, our ability to allow the recovery of such costs through a surcharge on a section 205 unbundled transmission rate is necessarily limited to public utilities.[721]

Rehearing Requests Opposing Commission Treatment of Stranded Costs Associated with Retail Wheeling Customers in Holding Company Intra-system Agreement Cases

A number of entities oppose the Commission's proposal to address on a case-by-case basis whether jurisdictional intra-system agreements may need to be amended in order to prevent inappropriate cost-shifting that could occur if one state disallows stranded cost recovery associated with retail wheeling customers. IN Com objects that the problem is not the actions of one state or another, but rather the terms of the intra-system agreement.

AR Com objects that Order No. 888 is factually in error because a state's treatment of retail stranded costs under

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[721]We note that the definition of "retail stranded cost" in section 35.26(b)(5) mistakenly refers to "a public utility or transmitting utility" (emphasis added). We will revise the definition to remove the reference to "transmitting utility."

the Entergy System Agreement cannot shift costs to other jurisdictions.[722] It submits that whenever retail load changes, whether due to retail wheeling or any other factor, responsibility ratios under Entergy's reserve equalization schedule, MSS-1, will change and costs will shift irrespective of the regulator's treatment of retail stranded costs. AR Com says that MSS-1 reveals no changes in calculations due to retail treatment of stranded costs or any other retail ratemaking; only **[30,420]** "excess" capacity costs of intermediate gas- and oil-fired plant are "shifted" under the Entergy System Agreement. Although the Commission has the authority to amend intra-system agreements when wholesale cost allocations have become unjust and unreasonable, AR Com submits that the Commission does not have jurisdiction to reach to the state level and dictate what retail ratepayers should pay to shareholders. AR Com maintains that a FERC-jurisdictional intra-system agreement extends only to sales for resale (transactions among subsidiaries), and that if a holding company believes that an intra-system agreement is unduly discriminatory as a result of a state's disallowance of costs, the holding company can propose to amend it.[723]

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[722] *See also* MO/KS Coms (the cost-shifting problem does not arise because of a particular state treatment of stranded costs; it arises because Entergy insists on recovering 100 percent of its costs even when some portion of the costs are not economical).

[723] AR Com also objects to the Commission's description of the issue as involving not only holding companies, but also other multi-state situations. AR Com says that "[t]he mere fact that a company's territory crosses state lines does not automatically mean that all assets serve all customers, or that all customers are required to bear the economic risk associated with all assets, or that assets

AR Com argues that retail stranded costs fall to state jurisdiction regardless of whether the utility is a member of an interstate holding company. AR Com says that because the costs at issue are in retail rate base, any Commission influence over their recovery could occur only through preemption, but preemption of a state disallowance from retail rate base is possible only if there is a "trapped cost." AR Com submits that a disallowance of retail rate base cost cannot result in a trapped cost because there is no inconsistency between two agencies acting within their jurisdiction; the Commission has no jurisdiction to act. AR Com maintains that, unlike the Grand Gulf situation, the Commission has not mandated any Entergy generation costs into retail rate base. It further says that different state decisions regarding recovery of retail costs are not inconsistent decisions; they represent each state applying its law to its facts. According to AR Com, decisions by states leading to less than full recovery could be deemed inconsistent decisions only if there were a federal guarantee of full cost recovery of retail costs, which there is not.

AR Com and MO/KS Coms assert that the Commission's proposal for holding company situations cannot apply to future holding companies, where there is no history of joint planning justifying cost equalization, nor can it apply to future investments. They contend that this would require an assumption that the utility subsidiaries of a registered holding company have planned, and should plan, together rather than

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that at one time were solely state-jurisdictional can somehow, by virtue of a company's decision to expand across state lines, become FERC-jurisdictional." AR Com at p. 11.

separately (i.e., that interaffiliate transactions are always more efficient than nonaffiliate transactions), and that such assumption would be sound only if having the transaction occur between affiliates is inherently more efficient than having the transaction occur between an affiliate and a nonaffiliate.

Commission Conclusion

The comments raised for the most part are either premature or reflect a misunderstanding of the Commission's decision. Contrary to AR Com's argument, the Commission in Order No. 888 in no way asserted jurisdiction over state determinations of stranded costs associated with retail wheeling customers. We agree with AR Com that our jurisdiction extends only to sales for resale (and transmission in interstate commerce) and that a holding company can seek to amend an intra-system agreement if it believes the agreement is unduly discriminatory as a result of a state's disallowance of costs. However, a holding company also may seek to amend an agreement *before* any potential disallowances can occur, to keep cost-shifting from occurring. The fact is that intra-system agreements which involve wholesale sales among affiliate companies in different states could, through operation of their reserve equalization formulas, result in customers in one or more states having to indirectly bear stranded costs that are disallowed in another state, and the Commission has a responsibility to prevent inappropriate cost-shifting. Such determinations can be made only on a case-by-case basis. Again, as we stated in Order No. 888, we encourage affected state commissions to propose mutually agreeable solutions to this potential problem.

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8. Evidentiary Demonstration Necessary -- Reasonable Expectation Standard

In Order No. 888, the Commission concluded that a utility seeking to recover stranded costs must demonstrate that it had a reasonable expectation of continuing to serve a customer. We stated that whether a utility had a reasonable expectation of continuing to serve a customer, and for how long, will be determined on a case-by-case basis, and will depend on all of the facts and circumstances. We also determined that the existence of a notice provision in a contract would create a rebuttable presumption that the utility had no reasonable expectation of serving the customer beyond the specified period. We said that whether or not a contract contains an "evergreen" or other automatic renewal provision will be a factor to be considered in determining whether the presumption of no reasonable expectation is rebutted in a particular case.[724]

We also said that we would apply the reasonable expectation standard to retail-turned-wholesale customers. We explained that, before the Commission will permit a utility to recover stranded costs, the utility must demonstrate that it incurred such costs based on a reasonable expectation that the retail-turned-wholesale customer would continue to receive bundled retail service. Whether the state law awards exclusive service territories and imposes a mandatory obligation to serve would be among the factors to be considered in

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[724] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,831; *mimeo* at pp. 570-72.

determining whether the reasonable expectation test is met in a particular case.[725]

We noted that Order No. 888 does not address who will bear the stranded costs caused by a departing generation customer if the Commission finds that the utility had no reasonable expectation of continuing to serve that customer. We indicated that we anticipate that, in such a case, a public utility will seek in subsequent requirements rate cases to have the costs reallocated among the remaining customers on its system. However, we stated that we were not prejudging that issue in the Rule.[726]

Rehearing Requests Opposing or Seeking Modification of the Reasonable Expectation Standard

APPA challenges the reasonable expectation standard as being too vague. It submits that the Commission has provided no guidance concerning application of the reasonable expectation standard, other than to state that it would decide the issue on a case-by-case basis. APPA objects that public utilities can exploit the uncertainty created by this standard, which will lead to costly and time-consuming litigation. IL Com supports replacing the reasonable expectation standard with a statutory, regulatory, contractual standard.

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[725]*FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,831; *mimeo* at p. 572. We indicated that the same procedures would apply to retail customers that obtain retail wheeling.

[726]*FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,831; *mimeo* at pp. 572-73.

Several entities contend that there is no basis to conclude that the reasonable expectation test could ever be met. VT DPS and Valero submit that, since 1973, utilities have known that a refusal to wheel power could subject them to antitrust liability. They say that Order No. 888 ignores the breadth of NRC licensing conditions. LEPA similarly argues that the reasonable expectation standard could not be met where NRC license conditions required an explicit wheeling commitment and prohibited the utility from including in the wheeling cost any amount attributable to the loss of customers due to the wheeling. It objects that delaying a decision on stranded cost recovery in such cases holds the threat of possible stranded cost charges over the heads of bulk power purchasers and thereby chills their ability to seek competitive sellers.

TAPS asserts that there should be an irrefutable presumption that no stranded costs are due from customers with pre-existing transmission rights, including customers who were the beneficiaries of NRC license conditions.[727] TAPS submits that there can be no legitimate "reasonable expectation" that such customers **[30,422]** would continue to purchase power if the price was higher than the market price.

Occidental Chemical asks the Commission to clarify that a utility could have had no reasonable expectation of recovering stranded costs from customers who, prior to the

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[727] AMP-Ohio submits that where transmission access and competition have existed to varying extents for decades, there should be an irrebuttable presumption of no reasonable expectation of continued service.

issuance of the NOPR, had the opportunity to switch to an alternative electric supplier or had the option of self-generating, obtaining on-site third-party generation, or municipalizing. Occidental Chemical further argues that it defies commercial expectations to allow a utility to argue that if a contract is silent on the issue of renewal, the obligation to purchase does not expire with the termination of the contract. It submits that the Commission has not shown that it has the authority to force customers to extend purchase agreements against their will in violation of accepted commercial practice.

A number of entities submit that the Commission erred in failing to treat a notice of termination provision as conclusive evidence that the utility had no reasonable expectation of continued service.[728] Several object that the Commission has failed to explain why the presence of a notice provision does not conclusively demonstrate the lack of a reasonable expectation and ipso facto terminate the obligation of the customer to purchase the product.[729] APPA objects that the Commission provided no evidence that it considered comments supporting making the presumption conclusive and that it found legally sufficient reasons to reject them.

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[728] *E.g.*, APPA, American Forest & Paper, Central Montana EC, NRECA, TDU Systems, Oglethorpe, IMPA, VT DPS, Valero, PA Munis.

[729] *E.g.*, APPA, NRECA, TDU Systems. See also VT DPS and Valero (by signing a contract with a termination date, the utility assumed the risk that the customer will elect to leave when the contract expires).

PA Munis objects that the rebuttable presumption represents an unjustified departure from the Commission's traditional policy of enforcing the express terms of notice provisions without any inquiry into the reasonable expectations of the party, provided that the agreements were negotiated in good faith and approved by the Commission.[730] PA Munis contends that wholesale requirements customers negotiated notice provisions with the knowledge that the Commission would enforce the notice provisions according to their terms, including the specific length of the term.[731] PA Munis argues that it is arbitrary and capricious to provide utilities an opportunity to seek to amend these contracts.

Several entities submit that the rebuttable presumption invites litigation and promotes uncertainty for customers.[732] APPA objects that the Commission has failed to establish the showing that it would require to overcome the presumption.

Referring to the Commission's discussion of evergreen provisions, Central Montana EC argues that it is wrong to infer from the existence of an automatic renewal provision that the parties intended that the contract might run longer

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[730]In support of its argument, PA Munis cites *Boston Edison Company*, 56 FPC 3414 (1976). *See also* American Forest & Paper.

[731]*Citing Kentucky Utilities Company*, 23 FERC ¶61,317 (1983); *Philadelphia Electric Company and Susquehanna Electric Company*, 65 FERC ¶61,303 (1993).

[732]*E.g.*, NRECA, IMPA, PA Munis.

than its initial term. Central Montana EC asserts that the presence of an evergreen provision infers simply that the parties agreed upon a mechanism to avoid the renegotiation of a power supply contract if, at the conclusion of its initial term, the parties were satisfied with the contract. It maintains that the parties' obligations are defined by the term and termination provisions of wholesale power contracts, and that the presence of a mechanism to avoid contract renegotiation does not alter those termination rights.

Commission Conclusion

We will reject the requests for rehearing of our decision to adopt a reasonable expectation standard to be applied on a case- by-case basis and to treat a notice provision in a contract as a rebuttable, not a conclusive, presumption of no reasonable expectation. Contrary to the claims of some entities, the Commission has explained the basis for its finding that utilities may have had an implicit obligation to serve their wholesale requirements customers and, therefore, that a utility should be given an opportunity to demonstrate that it incurred costs to provide **[30,423]** service to a customer and that it had a reasonable expectation that it would continue to serve the customer beyond the contract termination date. The same factors that some petitioners contend establish the absence of a reasonable expectation of continued service may be offered as evidence to be considered in determining whether the reasonable expectation test is met in a particular case.

We believe that our decision to treat a notice of termination provision in a contract as creating a rebuttable presumption that the utility had no reasonable expectation of

serving the customer beyond the period provided for in the notice provision is a reasonable one. It places evidentiary significance on the fact that a contract contains a notice of termination provision. Moreover, while it gives the utility an opportunity, based on the facts and circumstances of a particular case, to rebut the presumption of no reasonable expectation, it firmly places the burden of establishing reasonable expectation on the utility. Although some entities support treating notice provisions as a conclusive presumption of no reasonable expectation, as discussed below, we decline to adopt such an inflexible approach. Nevertheless, as we indicated in Order No. 888, when a utility is seeking a contract amendment to permit stranded cost recovery based on expectations beyond the stated term of the contract, we believe that the utility has a heavy burden in demonstrating that the contract ought to be modified.[733]

Contrary to the position of PA Munis, the rebuttable presumption is fully consistent with the Commission's past treatment of notice provisions. For example, the Kentucky Utilities Company case cited by PA Munis supports the proposition that, until a customer exercises a notice of termination provision, the utility is under an implicit obligation to continue to serve and plan for the future needs of the customer.[734] Thus, the presence of a notice of

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[733] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,665, 31,813-14; *mimeo* at p. 87, 522.

[734] *See Kentucky Utilities Company*, 23 FERC at pp. 61,679-80 ("Once it receives an effective notice of cancellation, Kentucky can stop planning for the future needs of that customer. . . . To be

termination provision in a contract (particularly one not yet exercised by the customer), in and of itself, may not necessarily support the conclusion that the utility could never prove that it reasonably expected to continue serving the customer beyond the notice period.[735]

In response to APPA's objection that the Commission has failed to establish the showing that it would require to overcome the presumption, we note that the Commission cannot establish such a showing upfront because whether there is sufficient evidence to rebut the presumption of no reasonable expectation will depend on the facts of each case.

We appreciate the concerns expressed by some entities that the rebuttable presumption may increase the customer's uncertainty by inviting litigation. We have carefully weighed the pros and cons of treating a notice provision as a rebuttable presumption of no reasonable expectation versus the pros and cons of treating it as a conclusive presumption of no reasonable expectation. It is true, as some entities assert, that the rebuttable presumption approach presents the potential for litigation between the parties as to whether, in a particular case, the utility can rebut the presumption. The alternative

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effective a notice of cancellation must contain a specification of the source of supply, the date on which the source of supply will be available, and an affidavit from the supplier that it will supply the customer on the date the contract ends.").

[735]*See Potomac Electric Power Company*, 43 FERC ¶61,189 (1988) (suspending a notice of termination for five months due to questions about the impact of the proposed cancellation on service reliability).

would be to treat all contracts with notice of termination provisions as conclusive evidence that the utility could have had no reasonable expectation that it would continue to serve the customer beyond the specified notice period. While the latter approach presumably would reduce the number of cases in which the issue of a utility's reasonable expectation would have to be litigated, it would do so only by prohibiting a utility from ever demonstrating that, notwithstanding the existence of a notice provision, based on the facts of a particular case, the utility reasonably expected to continue serving the customer. While we do not prejudge the likelihood of a utility being able to rebut the presumption in a particular case, we believe that **[30,424]** it would not be in the public interest for the Commission to absolutely preclude a utility from being able to make such a showing. On this basis, we conclude that treating a notice provision as a rebuttable, rather than a conclusive, presumption that the utility did not have a reasonable expectation of continuing service to the customer is, on balance, the fairer and more equitable approach.

Central Montana EC asserts that it is wrong to infer from the existence of an automatic renewal provision that the parties intended that the contract might run longer than its initial term. However, our statement in Order No. 888 that the existence of an automatic renewal provision will be a factor to be considered in determining whether the presumption of no reasonable expectation is rebutted in a particular case makes no such inference. Whether the utility can rebut the presumption will depend on the facts of each case.

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I. Common Service Provisions

1 Definitions

1.1 Ancillary Services: Those services that are necessary to support the transmission of capacity and energy from resources to loads while maintaining reliable operation of the Transmission Provider's Transmission System in accordance with Good Utility Practice.

1.2 Annual Transmission Costs: The total annual cost of the Transmission System for purposes of Network Integration Transmission Service shall be the amount specified in Attachment H until amended by the Transmission Provider or modified by the Commission.

1.3 Application: A request by an Eligible Customer for transmission service pursuant to the provisions of the Tariff.

1.4 Commission: The Federal Energy Regulatory Commission.

1.5 Completed Application: An Application that satisfies all of the information and other requirements of the Tariff, including any required deposit.

1.6 Control Area: An electric power system or combination of electric power systems to which a common automatic generation control scheme is applied in order to:

(1) match, at all times, the power output of the generators within the electric power system(s) and capacity and energy purchased from entities (Name of Transmission Provider) Open Access Transmission Tariff Original Sheet No. 10 outside the electric power system(s), with the load within the electric power system(s);

(2) maintain scheduled interchange with other Control Areas, within the limits of Good Utility Practice;

(3) maintain the frequency of the electric power system(s) within reasonable limits in accordance with Good Utility Practice; and

(4) provide sufficient generating capacity to maintain operating reserves in accordance with Good Utility Practice.

1.7 Curtailment: A reduction in firm or non-firm transmission service in response to a transmission capacity **[30,508]** shortage as a result of system reliability conditions.

1.8 Delivering Party: The entity supplying capacity and energy to be transmitted at Point(s) of Receipt.

1.9 Designated Agent: Any entity that performs actions or functions on behalf of the Transmission Provider, an Eligible Customer, or the Transmission Customer required under the Tariff.

1.10 Direct Assignment Facilities: Facilities or portions of facilities that are constructed by the Transmission Provider for the sole use/benefit of a particular Transmission Customer requesting service under the Tariff. Direct Assignment Facilities shall be specified in the Service Agreement that governs service to the Transmission Customer and shall be subject to Commission approval.

1.11 Eligible Customer: (i) Any electric utility (including the Transmission Provider and any power marketer), Federal power marketing agency, or any person generating electric energy for sale for resale is an Eligible Customer under the Tariff. Electric energy sold or produced by such entity may be electric energy produced in the United States, Canada or Mexico. However, with respect to transmission service that the Commission is prohibited from ordering by Section 212(h) of the Federal Power Act, such entity is eligible only if the service is provided pursuant to a state requirement that the Transmission Provider offer the unbundled transmission service, or pursuant to a voluntary offer of such service by the Transmission Provider. (ii) Any retail customer taking unbundled transmission service pursuant to a state requirement that the Transmission Provider offer the transmission service, or pursuant to a voluntary offer of such service by the Transmission Provider, is an Eligible Customer under the Tariff.

1.12 Facilities Study: An engineering study conducted by the Transmission Provider to determine the required modifications to the Transmission Provider's Transmission System, including the cost and scheduled completion date for such modifications, that will be required to provide the requested transmission service.

1.13 Firm Point-To-Point Transmission Service: Transmission Service under this Tariff that is reserved and/or scheduled between specified Points of Receipt and Delivery pursuant to Part II of this Tariff.

1.14 Good Utility Practice: Any of the practices, methods and acts engaged in or approved by a significant portion of the electric utility industry during the relevant time period, or any of the practices, methods and acts which, in the exercise of reasonable judgment in light of the facts known at the time the decision was made, could have been expected to accomplish the desired result at a reasonable cost consistent with good business practices, reliability, safety and expedition. Good Utility Practice is not intended to be limited to the optimum practice, method, or act to the exclusion of all others, but rather to be acceptable practices, methods, or acts generally accepted in the region.

1.15 Interruption: A reduction in non-firm transmission service due to economic reasons pursuant to Section 14.7.

1.16 Load Ratio Share: Ratio of a Transmission Customer's Network Load to the Transmission Provider's total load computed in accordance with Sections 34.2 and 34.3 of the Network Integration Transmission Service under

Part III the Tariff and calculated on a rolling twelve month basis.

1.17 Load Shedding: The systematic reduction of system demand by temporarily decreasing load in response to transmission system or area capacity shortages, system instability, or voltage control considerations under Part III of the Tariff.

1.18 Long-Term Firm Point-To-Point Transmission Service: Firm Point-To-Point Transmission Service under Part II of the Tariff with a term of one year or more.

1.19 Native Load Customers: The wholesale and retail power customers of the Transmission Provider on whose behalf the Transmission Provider, by statute, franchise, regulatory requirement, or contract, has undertaken an obligation to construct and operate the Transmission Provider's system to meet the reliable electric needs of such customers.

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1.20 Network Customer: An entity receiving transmission service pursuant to the terms of the Transmission Provider's Network Integration Transmission Service under Part III of the Tariff.

1.21 Network Integration Transmission Service: The transmission service provided under Part III of the Tariff.

1.22 Network Load: The load that a Network Customer designates for Network Integration Transmission Service under Part III of the Tariff. The Network Customer's

Network Load shall include all load served by the output of any Network Resources designated by the Network Customer. A Network Customer may elect to designate less than its total load as Network Load but may not designate only part of the load at a discrete Point of Delivery. Where a Eligible Customer has elected not to designate a particular load at discrete points of delivery as Network Load, the Eligible Customer is responsible for making separate arrangements under Part II of the Tariff for any Point-To-Point Transmission Service that may be necessary for such non-designated load.

1.23 Network Operating Agreement: An executed agreement that contains the terms and conditions under which the Network Customer shall operate its facilities and the technical and operational matters associated with the implementation of Network Integration Transmission Service under Part III of the Tariff.

1.24 Network Operating Committee: A group made up of representatives from the Network Customer(s) and the Transmission Provider established to coordinate operating criteria and other technical considerations required for implementation of Network Integration Transmission Service under Part III of this Tariff.

1.25 Network Resource: Any designated generating resource owned, purchased or leased by a Network Customer under the Network Integration Transmission Service Tariff. Network Resources do not include any resource, or any portion thereof, that is committed for sale to third parties or otherwise cannot be called upon to meet the Network Customer's Network Load on a non-interruptible basis.

1.26 Network Upgrades: Modifications or additions to transmission-related facilities that are integrated with and support the Transmission Provider's overall Transmission System for the general benefit of all users of such Transmission System.

1.27 Non-Firm Point-To-Point Transmission Service: Point-To-Point Transmission Service under the Tariff that is reserved and scheduled on an as-available basis and is subject to Curtailment or Interruption as set forth in Section 14.7 under Part II of this Tariff. Non-Firm Point-To-Point Transmission Service is available on a stand-alone basis for periods ranging from one hour to one month.

1.28 Open Access Same-Time Information System (OASIS): The information system and standards of conduct contained in Part 37 of the Commission's regulations and all additional requirements implemented by subsequent Commission orders dealing with OASIS.

1.29 Part I: Tariff Definitions and Common Service Provisions contained in Sections 2 through 12.

1.30 Part II: Tariff Sections 13 through 27 pertaining to Point-To-Point Transmission Service in conjunction with the applicable Common Service Provisions of Part I and appropriate Schedules and Attachments.

1.31 Part III: Tariff Sections 28 through 35 pertaining to Network Integration Transmission Service in conjunction with the applicable Common Service Provisions of Part I and appropriate Schedules and Attachments.

1.32 Parties: The Transmission Provider and the Transmission Customer receiving service under the Tariff.

1.33 Point(s) of Delivery: Point(s) on the Transmission Provider's Transmission System where capacity and energy transmitted by the Transmission Provider will be made available to the Receiving Party under Part II of the Tariff. The Point(s) of Delivery shall be (Name of Transmission Provider) Open Access Transmission Tariff Original Sheet No. 17 specified in the Service Agreement for Long-Term Firm Point-To-Point Transmission Service.

1.34 Point(s) of Receipt: Point(s) of interconnection on the Transmission **[30,510]** Provider's Transmission System where capacity and energy will be made available to the Transmission Provider by the Delivering Party under Part II of the Tariff. The Point(s) of Receipt shall be specified in the Service Agreement for Long-Term Firm Point-To-Point Transmission Service.

1.35 Point-To-Point Transmission Service: The reservation and transmission of capacity and energy on either a firm or non-firm basis from the Point(s) of Receipt to the Point(s) of Delivery under Part II of the Tariff.

1.36 Power Purchaser: The entity that is purchasing the capacity and energy to be transmitted under the Tariff.

1.37 Receiving Party: The entity receiving the capacity and energy transmitted by the Transmission Provider to Point(s) of Delivery.

1.38 Regional Transmission Group (RTG): A voluntary organization of transmission owners, transmission users and other entities approved by the Commission to efficiently coordinate transmission planning (and expansion), operation and use on a regional (and interregional) basis.

1.39 Reserved Capacity: The maximum amount of capacity and energy that the Transmission Provider agrees to transmit for the Transmission Customer over the Transmission Provider's Transmission System between the Point(s) of Receipt and the Point(s) of Delivery under Part II of the Tariff. Reserved Capacity shall be expressed in terms of whole megawatts on a sixty (60) minute interval (commencing on the clock hour) basis.

1.40 Service Agreement: The initial agreement and any amendments or supplements thereto entered into by the Transmission Customer and the Transmission Provider for service under the Tariff.

1.41 Service Commencement Date: The date the Transmission Provider begins to provide service pursuant to the terms of an executed Service Agreement, or the date the Transmission Provider begins to provide service in accordance with Section 15.3 or Section 29.1 under the Tariff.

1.42 Short-Term Firm Point-To-Point Transmission Service: Firm Point-To-Point Transmission Service under Part II of the Tariff with a term of less than one year.

1.43 System Impact Study: An assessment by the Transmission Provider of (i) the adequacy of the Transmission

System to accommodate a request for either Firm Point-To-Point Transmission Service or Network Integration

Transmission Service and (ii) whether any additional costs may be incurred in order to provide transmission service.

1.44 Third-Party Sale: Any sale for resale in interstate commerce to a Power Purchaser that is not designated as part of Network Load under the Network Integration Transmission Service.

1.45 Transmission Customer: Any Eligible Customer (or its Designated Agent) that (i) executes a Service Agreement, or (ii) requests in writing that the Transmission Provider file with the Commission, a proposed unexecuted Service Agreement to receive transmission service under Part II of the Tariff. This term is used in the Part I Common Service Provisions to include customers receiving transmission service under Part II and Part III of this Tariff.

1.46 Transmission Provider: The public utility (or its Designated Agent) that owns, controls, or operates facilities used for the transmission of electric energy in interstate commerce and provides transmission service under the Tariff.

1.47 Transmission Provider's Monthly Transmission System Peak: The maximum firm usage of the Transmission Provider's Transmission System in a calendar month.

1.48 Transmission Service: Point-To-Point Transmission Service provided under Part II of the Tariff on a firm and non-firm basis.

1.49 Transmission System: The facilities owned, controlled or operated by the Transmission Provider that are used to provide transmission service under Part II and Part III of the Tariff.

2 Initial Allocation and Renewal Procedures

2.1 Initial Allocation of Available Transmission Capability: For purposes of determining whether existing **[30,511]** capability on the Transmission Provider's Transmission System is adequate to accommodate a request for firm service under this Tariff, all Completed Applications for new firm transmission service received during the initial sixty (60) day period commencing with the effective date of the Tariff will be deemed to have been filed simultaneously. A lottery system conducted by an independent party shall be used to assign priorities for Completed Applications filed simultaneously. All Completed Applications for firm transmission service received after the initial sixty (60) day period shall be assigned a priority pursuant to Section 13.2.

2.2 Reservation Priority For Existing Firm Service Customers: Existing firm service customers (wholesale requirements and transmission-only, with a contract term of one-year or more), have the right to continue to take transmission service from the Transmission Provider when the contract expires, rolls over or is renewed. This transmission reservation priority is independent of whether the existing customer continues to purchase capacity and energy from the Transmission Provider or elects to purchase capacity and energy from another supplier. If at the end of the contract term, the Transmission Provider's Transmission System cannot accommodate all of the requests for transmission

service the existing firm service customer must agree to accept a contract term at least equal to a competing request by any new Eligible Customer and to pay the current just and reasonable rate, as approved by the Commission, for such service. This transmission reservation priority for existing firm service customers is an ongoing right that may be exercised at the end of all firm contract terms of one-year or longer.

3 *Ancillary Services*

Ancillary Services are needed with transmission service to maintain reliability within and among the Control Areas affected by the transmission service. The Transmission Provider is required to provide (or offer to arrange with the local Control Area operator as discussed below), and the Transmission Customer is required to purchase, the following Ancillary Services (i) Scheduling, System Control and Dispatch, and (ii) Reactive Supply and Voltage Control from Generation Sources.

The Transmission Provider is required to offer to provide (or offer to arrange with the local Control Area operator as discussed below) the following Ancillary Services only to the Transmission Customer serving load within the Transmission Provider's Control Area (i) Regulation and Frequency Response, (ii) Energy Imbalance, (iii) Operating Reserve - Spinning, and (iv) Operating Reserve - Supplemental. The Transmission Customer serving load within the Transmission Provider's Control Area is required to acquire these Ancillary Services, whether from the Transmission Provider, from a third party, or by self-supply. The Transmission Customer may not decline the Transmission

Provider's offer of Ancillary Services unless it demonstrates that it has acquired the Ancillary Services from another source. The Transmission Customer must list in its Application which Ancillary Services it will purchase from the Transmission Provider.

If the Transmission Provider is a public utility providing transmission service but is not a Control Area operator, it may be unable to provide some or all of the Ancillary Services. In this case, the Transmission Provider can fulfill its obligation to provide Ancillary Services by acting as the Transmission Customer's agent to secure these Ancillary Services from the Control Area operator. The Transmission Customer may elect to (i) have the Transmission Provider act as its agent, (ii) secure the Ancillary Services directly from the Control Area operator, or (iii) secure the Ancillary Services (discussed in Schedules 3, 4, 5 and 6) from a third party or by self-supply when technically feasible.

The Transmission Provider shall specify the rate treatment and all related terms and conditions in the event of an unauthorized use of Ancillary Services by the Transmission Customer.

The specific Ancillary Services, prices and/or compensation methods are described on the Schedules that are attached to and made a part of the Tariff. Three principal requirements apply to discounts for Ancillary Services provided by the Transmission Provider in conjunction with its provision of transmission service **[30,512]** as follows: (1) any offer of a discount made by the Transmission Provider must be announced to all Eligible Customers solely by posting on the OASIS, (2) any customer-initiated requests for discounts

(including requests for use by one's wholesale merchant or an affiliate's use) must occur solely by posting on the OASIS, and (3) once a discount is negotiated, details must be immediately posted on the OASIS. A discount agreed upon for an Ancillary Service must be offered for the same period to all Eligible Customers on the Transmission Provider's system. Sections 3.1 through 3.6 below list the six Ancillary Services.

3.1 Scheduling, System Control and Dispatch Service: The rates and/or methodology are described in Schedule 1.

3.2 Reactive Supply and Voltage Control from Generation Sources Service: The rates and/or methodology are described in Schedule 2.

3.3 Regulation and Frequency Response Service: Where applicable the rates and/or methodology are described in Schedule 3.

3.4 Energy Imbalance Service: Where applicable the rates and/or methodology are described in Schedule 4.

3.5 Operating Reserve - Spinning Reserve Service: Where applicable the rates and/or methodology are described in Schedule 5.

3.6 Operating Reserve - Supplemental Reserve Service: Where applicable the rates and/or methodology are described in Schedule 6.

4 Open Access Same-Time Information System (OASIS)

Terms and conditions regarding Open Access Same-Time Information System and standards of conduct are set forth in 18 CFR §37 of the Commission's regulations (Open Access Same-Time Information System and Standards of Conduct for Public Utilities). In the event available transmission capability as posted on the OASIS is insufficient to accommodate a request for firm transmission service, additional studies may be required as provided by this Tariff pursuant to Sections 19 and 32.

5 Local Furnishing Bonds

5.1 Transmission Providers That Own Facilities Financed by Local Furnishing Bonds: This provision is applicable only to Transmission Providers that have financed facilities for the local furnishing of electric energy with tax-exempt bonds, as described in Section 142(f) of the Internal Revenue Code ("local furnishing bonds"). Notwithstanding any other provision of this Tariff, the Transmission Provider shall not be required to provide transmission service to any Eligible Customer pursuant to this Tariff if the provision of such transmission service would jeopardize the tax- exempt status of any local furnishing bond(s) used to finance the Transmission Provider's facilities that would be used in providing such transmission service.

5.2 Alternative Procedures for Requesting Transmission Service:

(i) If the Transmission Provider determines that the provision of transmission service requested by an Eligible

Customer would jeopardize the tax-exempt status of any local furnishing bond(s) used to finance its facilities that would be used in providing such transmission service, it shall (Name of Transmission Provider) Open Access Transmission Tariff Original Sheet No. 26 advise the Eligible Customer within thirty (30) days of receipt of the Completed Application.

(ii) If the Eligible Customer thereafter renews its request for the same transmission service referred to in (i) by tendering an application under Section 211 of the Federal Power Act, the Transmission Provider, within ten (10) days of receiving a copy of the Section 211 application, will waive its rights to a request for service under Section 213(a) of the Federal Power Act and to the issuance of a proposed order under Section 212(c) of the Federal Power Act. The Commission, upon receipt of the Transmission Provider's waiver of its rights to a request for service under Section 213(a) of the Federal Power Act and to the issuance of a proposed order under Section 212(c) of the Federal Power Act, shall issue an order under Section 211 of the Federal Power Act. Upon issuance of the order under Section 211 of the Federal Power Act, the Transmission Provider shall be required to provide the requested transmission service in accordance with the terms and conditions of this Tariff.

[30,513]
6 *Reciprocity*

A Transmission Customer receiving transmission service under this Tariff agrees to provide comparable transmission service that it is capable of providing to the Transmission Provider on similar terms and conditions over facilities used for the transmission of electric energy owned,

controlled or operated by the Transmission Customer and over facilities used for the transmission of electric energy owned, controlled or operated by the Transmission Customer's corporate affiliates. A Transmission Customer that is a member of a power pool or Regional Transmission Group also agrees to provide comparable transmission service to the members of such power pool and Regional Transmission Group on similar terms and conditions over facilities used for the transmission of electric energy owned, controlled or operated by the Transmission Customer and over facilities used for the transmission of electric energy owned, controlled or operated by the Transmission Customer's corporate affiliates.

This reciprocity requirement applies not only to the Transmission Customer that obtains transmission service under the Tariff, but also to all parties to a transaction that involves the use of transmission service under the Tariff, including the power seller, buyer and any intermediary, such as a power marketer. This reciprocity requirement also applies to any Eligible Customer that owns, controls or operates transmission facilities that uses an intermediary, such as a power marketer, (Name of Transmission Provider) Open Access Transmission Tariff Original Sheet No. 28 to request transmission service under the Tariff. If the Transmission Customer does not own, control or operate transmission facilities, it must include in its Application a sworn statement of one of its duly authorized officers or other representatives that the purpose of its Application is not to assist an Eligible Customer to avoid the requirements of this provision.

7 Billing and Payment

7.1 Billing Procedure: Within a reasonable time after the first day of each month, the Transmission Provider shall submit an invoice to the Transmission Customer for the charges for all services furnished under the Tariff during the preceding month. The invoice shall be paid by the Transmission Customer within twenty (20) days of receipt. All payments shall be made in immediately available funds payable to the Transmission Provider, or by wire transfer to a bank named by the Transmission Provider.

7.2 Interest on Unpaid Balances: Interest on any unpaid amounts (including amounts placed in escrow) shall be calculated in accordance with the methodology specified for interest on refunds in the Commission's regulations at 18 C.F.R §35.19a(a)(2)(iii). Interest on delinquent amounts shall be calculated from the due date of the bill to the date of payment. When payments are made by mail, bills shall be considered as having been paid on the date of receipt by the Transmission Provider.

7.3 Customer Default: In the event the Transmission Customer fails, for any reason other than a billing dispute as described below, to make payment to the Transmission Provider on or before the due date as described above, and such failure of payment is not corrected within thirty (30) calendar days after the Transmission Provider notifies the Transmission Customer to cure such failure, a default by the Transmission Customer shall be deemed to exist. Upon the occurrence of a default, the Transmission Provider may initiate a proceeding with the Commission to terminate service but shall not terminate service until the Commission so

approves any such request. In the event of a billing dispute between the Transmission Provider and the Transmission Customer, the Transmission Provider will continue to provide service under the Service Agreement as long as the Transmission Customer (i) continues to make all payments not in dispute, and (ii) pays into an independent escrow account the portion of the invoice in dispute, pending resolution of such dispute. If the Transmission Customer fails to meet these two requirements for continuation of service, then the Transmission Provider may provide notice to the Transmission Customer of its intention to suspend service in sixty (60) days, in accordance with Commission policy.

8 *Accounting for the Transmission Provider's Use of the Tariff*

The Transmission Provider shall record the following amounts, as outlined below.

8.1 Transmission Revenues: Include in a separate operating revenue account or subaccount the revenues it receives from Transmission Service when making Third-Party Sales under Part II of the Tariff.

8.2 Study Costs and Revenues: Include in a separate transmission operating expense account or subaccount, costs properly chargeable to expense that are incurred to perform any System Impact Studies or Facilities Studies which the Transmission Provider conducts to determine if it must construct new transmission facilities or upgrades necessary for its own uses, including making Third-Party Sales under the Tariff; and include in a separate operating revenue account or

subaccount the revenues received for System Impact Studies or Facilities Studies performed when such amounts are separately stated and identified in the Transmission Customer's billing under the Tariff.

9 *Regulatory Filings*

Nothing contained in the Tariff or any Service Agreement shall be construed as affecting in any way the right of the Transmission Provider to unilaterally make application to the Commission for a change in rates, terms and conditions, charges, classification of service, Service Agreement, rule or regulation under Section 205 of the Federal Power Act and pursuant to the Commission's rules and regulations promulgated thereunder.

Nothing contained in the Tariff or any Service Agreement shall be construed as affecting in any way the ability of any Party receiving service under the Tariff to exercise its rights under the Federal Power Act and pursuant to the Commission's rules and regulations promulgated thereunder.

10 *Force Majeure and Indemnification*

10.1 Force Majeure: An event of Force Majeure means any act of God, labor disturbance, act of the public enemy, war, insurrection, riot, fire, storm or flood, explosion, breakage or accident to machinery or equipment, any Curtailment, order, regulation or restriction imposed by governmental military or lawfully established civilian authorities, or any other cause beyond a Party's control. A Force Majeure event does not include an act of negligence or

intentional wrongdoing. Neither the Transmission Provider nor the Transmission Customer will be considered in default as to any obligation under this Tariff if prevented from fulfilling the obligation due to an event of Force Majeure. However, a Party whose performance under this Tariff is hindered by an event of Force Majeure shall make all reasonable efforts to perform its obligations under this Tariff.

10.2 Indemnification: The Transmission Customer shall at all times indemnify, defend, and save the Transmission Provider harmless from, any and all damages, losses, claims, including claims and actions relating to injury to or death of any person or damage to property, demands, suits, recoveries, costs and expenses, court costs, attorney fees, and all other obligations by or to third parties, arising out of or resulting from the Transmission Provider s performance of its obligations under this Tariff on behalf of the Transmission Customer, except in cases of negligence or intentional wrongdoing by the Transmission Provider.

11 ***Creditworthiness***

For the purpose of determining the ability of the Transmission Customer to meet its obligations related to service hereunder, the Transmission Provider may require reasonable credit review procedures. This review shall be made in accordance with standard commercial practices. In addition, the Transmission Provider may require the Transmission Customer to provide and maintain in effect during the term of the Service Agreement, an unconditional and irrevocable letter of credit as security to meet its responsibilities and obligations under the Tariff, or an alternative form of security proposed by the Transmission

Customer and acceptable to the Transmission Provider and consistent with commercial practices established by the Uniform Commercial Code that protects the Transmission Provider against the risk of non-payment.

12 *Dispute Resolution Procedures*

12.1 Internal Dispute Resolution Procedures: Any dispute between a **[30,515]** Transmission Customer and the Transmission Provider involving transmission service under the Tariff (excluding applications for rate changes or other changes to the Tariff, or to any Service Agreement entered into under the Tariff, which shall be presented directly to the Commission for resolution) shall be referred to a designated senior representative of the Transmission Provider and a senior representative of the Transmission Customer for resolution on an informal basis as promptly as practicable. In the event the designated representatives are unable to resolve the dispute within thirty (30) days [or such other period as the Parties may agree upon] by mutual agreement, such dispute may be submitted to arbitration and resolved in accordance with the arbitration procedures set forth below.

12.2 External Arbitration Procedures: Any arbitration initiated under the Tariff shall be conducted before a single neutral arbitrator appointed by the Parties. If the Parties fail to agree upon a single arbitrator within ten (10) days of the referral of the dispute to arbitration, each Party shall choose one arbitrator who shall sit on a three-member arbitration panel. The two arbitrators so chosen shall within twenty (20) days select a third arbitrator to chair the arbitration panel. In either case, the arbitrators shall be knowledgeable in electric utility matters, including electric

transmission and bulk power issues, and shall not have any current or past substantial business or financial relationships with any party to the arbitration (except prior arbitration). The arbitrator(s) shall provide each of the Parties an opportunity to be heard and, except as otherwise provided herein, shall generally conduct the arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association and any applicable Commission regulations or Regional Transmission Group rules.

12.3 Arbitration Decisions: Unless otherwise agreed, the arbitrator(s) shall render a decision within ninety (90) days of appointment and shall notify the Parties in writing of such decision and the reasons therefor. The arbitrator(s) shall be authorized only to interpret and apply the provisions of the Tariff and any Service Agreement entered into under the Tariff and shall have no power to modify or change any of the above in any manner. The decision of the arbitrator(s) shall be final and binding upon the Parties, and judgment on the award may be entered in any court having jurisdiction. The decision of the arbitrator(s) may be appealed solely on the grounds that the conduct of the arbitrator(s), or the decision itself, violated the standards set forth in the Federal Arbitration Act and/or the Administrative Dispute Resolution Act. The final decision of the arbitrator must also be filed with the Commission if it affects jurisdictional rates, terms and conditions of service or facilities.

12.4 Costs: Each Party shall be responsible for its own costs incurred during the arbitration process and for the following costs, if applicable:

(A) the cost of the arbitrator chosen by the Party to sit on the three member panel and one half of the cost of the third arbitrator chosen; or

(B) one half the cost of the single arbitrator jointly chosen by the Parties.

12.5 Rights Under The Federal Power Act: Nothing in this section shall restrict the rights of any party to file a Complaint with the Commission under relevant provisions of the Federal Power Act.

II. Point-To-Point Transmission Service

Preamble

The Transmission Provider will provide Firm and Non-Firm Point-To-Point Transmission Service pursuant to the applicable terms and conditions of this Tariff. Point-To-Point Transmission Service is for the receipt of capacity and energy at designated Point(s) of Receipt and the transmission of such capacity and energy to designated Point(s) of Delivery.

13 *Nature of Firm Point-To-Point Transmission Service*

13.1 Term: The minimum term of Firm Point-To-Point Transmission Service shall be one day and the maximum term shall be specified in the Service Agreement.

13.2 Reservation Priority: Long-Term Firm Point-To-Point Transmission Service shall be available on a first-come, **[30,516]** first-served basis *i.e.*, in the chronological

sequence in which each Transmission Customer has reserved service. Reservations for Short-Term Firm Point-To-Point Transmission Service will be conditional based upon the length of the requested transaction. If the Transmission System becomes oversubscribed, requests for longer term service may preempt requests for shorter term service up to the following deadlines: one day before the commencement of daily service, one week before the commencement of weekly service, and one month before the commencement of monthly service. Before the conditional reservation deadline, if available transmission capability is insufficient to satisfy all Applications, an Eligible Customer with a reservation for shorter term service has the right of first refusal to match any longer term reservation before losing its reservation priority. A longer term competing request for Short-Term Firm Point-To-Point Transmission Service will be granted if the Eligible Customer with the right of first refusal does not agree to match the competing request within 24 hours (or earlier if necessary to comply with the scheduling deadlines provided in section 13.8) from being notified by the Transmission Provider of a longer-term competing request for Short-Term Firm Point-To-Point Transmission Service. After the conditional reservation deadline, service will commence pursuant to the terms of Part II of the Tariff. Firm Point-To-Point Transmission Service will always have a reservation priority over Non-Firm Point-To-Point Transmission Service under the Tariff. All Long-Term Firm Point-To-Point Transmission Service will have equal reservation priority with Native Load Customers and Network Customers. Reservation priorities for existing firm service customers are provided in Section 2.2.

13.3 Use of Firm Transmission Service by the Transmission Provider: The Transmission Provider will be subject to the rates, terms and conditions of Part II of the Tariff when making Third-Party Sales under (i) agreements executed on or after [insert date sixty (60) days after publication in Federal Register] or (ii) agreements executed prior to the aforementioned date that the Commission requires to be unbundled, by the date specified by the Commission. The Transmission Provider will maintain separate accounting, pursuant to Section 8, for any use of the Point-To-Point Transmission Service to make Third-Party Sales.

13.4 Service Agreements: The Transmission Provider shall offer a standard form Firm Point-To-Point Transmission Service Agreement (Attachment A) to an Eligible Customer when it submits a Completed Application for Long-Term Firm Point-To-Point Transmission Service. The Transmission Provider shall offer a standard form Firm Point-To-Point Transmission Service Agreement (Attachment A) to an Eligible Customer when it first submits a Completed Application for Short-Term Firm Point-To-Point Transmission Service pursuant to the Tariff. Executed Service Agreements that contain the information required under the Tariff shall be filed (Name of Transmission Provider) Open Access Transmission Tariff Original Sheet No. 40 with the Commission in compliance with applicable Commission regulations.

13.5 Transmission Customer Obligations for Facility Additions or Redispatch Costs: In cases where the Transmission Provider determines that the Transmission System is not capable of providing Firm Point-To-Point Transmission Service without (1) degrading or impairing the

reliability of service to Native Load Customers, Network Customers and other Transmission Customers taking Firm Point-To-Point Transmission Service, or (2) interfering with the Transmission Provider's ability to meet prior firm contractual commitments to others, the Transmission Provider will be obligated to expand or upgrade its Transmission System pursuant to the terms of Section 15.4. The Transmission Customer must agree to compensate the Transmission Provider for any necessary transmission facility additions pursuant to the terms of Section 27. To the extent the Transmission Provider can relieve any system constraint more economically by redispatching the Transmission Provider's resources than through constructing Network Upgrades, it shall do so, provided that the Eligible Customer agrees to compensate the Transmission Provider pursuant to the terms of Section 27. Any redispatch, Network Upgrade **[30,517]** or Direct Assignment Facilities costs (Name of Transmission Provider) Open Access Transmission Tariff Original Sheet No. 41 to be charged to the Transmission Customer on an incremental basis under the Tariff will be specified in the Service Agreement prior to initiating service.

13.6 Curtailment of Firm Transmission Service: In the event that a Curtailment on the Transmission Provider's Transmission System, or a portion thereof, is required to maintain reliable operation of such system, Curtailments will be made on a non-discriminatory basis to the transaction(s) that effectively relieve the constraint. If multiple transactions require Curtailment, to the extent practicable and consistent with Good Utility Practice, the Transmission Provider will curtail service to Network Customers and Transmission Customers taking Firm Point-To-Point Transmission Service on a basis comparable to the curtailment of service to the

Transmission Provider's Native Load Customers. All Curtailments will be made on a non-discriminatory basis, however, Non-Firm Point-To-Point Transmission Service shall be subordinate to Firm Transmission Service. When the Transmission Provider determines that an electrical emergency exists on its Transmission System and implements emergency procedures to Curtail Firm Transmission Service, the Transmission Customer shall make the required reductions upon request of the Transmission Provider. However, the Transmission Provider reserves the right to Curtail, in whole or in part, any Firm Transmission Service provided under the Tariff when, in the Transmission Provider's sole discretion, an emergency or other unforeseen condition impairs or degrades the reliability of its Transmission System. The Transmission Provider will notify all affected Transmission Customers in a timely manner of any scheduled Curtailments.

13.7 Classification of Firm Transmission Service:

(a) The Transmission Customer taking Firm Point-To- Point Transmission Service may (1) change its Receipt and Delivery Points to obtain service on a non-firm basis consistent with the terms of Section 22.1 or (2) request a modification of the Points of Receipt or Delivery on a firm basis pursuant to the terms of Section 22.2.

(b) The Transmission Customer may purchase transmission service to make sales of capacity and energy from multiple generating units that are on the Transmission Provider's Transmission System. For such a purchase of transmission service, the resources will be designated as multiple Points of Receipt, unless the multiple generating

units are at the same generating plant in which case the units would be treated as a single Point of Receipt.

(c) The Transmission Provider shall provide firm deliveries of capacity and energy from the Point(s) of Receipt to the Point(s) of Delivery. Each Point of Receipt at which firm transmission capacity is reserved by the Transmission Customer shall be set forth in the Firm Point-To-Point Service Agreement for Long-Term Firm Transmission Service along with a corresponding capacity reservation associated with each Point of Receipt. Points of Receipt and corresponding capacity reservations shall be as mutually agreed upon by the Parties for Short-Term Firm Transmission. Each Point of Delivery at which firm transmission capacity is reserved by the Transmission Customer shall be set forth in the Firm Point-To-Point Service Agreement for Long-Term Firm Transmission Service along with a corresponding capacity reservation associated with each Point of Delivery. Points of Delivery and corresponding capacity reservations shall be as mutually agreed upon by the Parties for Short-Term Firm Transmission. The greater of either (1) the sum of the capacity reservations at the Point(s) of Receipt, or (2) the sum of the capacity reservations at the Point(s) of Delivery shall be the Transmission Customer's Reserved Capacity. The Transmission Customer will be billed for its Reserved Capacity under the terms of Schedule 7. The Transmission Customer may not exceed its firm capacity reserved at each Point of Receipt and each Point of Delivery except as otherwise specified in Section 22. The Transmission Provider shall specify the rate treatment and all related terms and conditions applicable in the event that a Transmission Customer (including Third-Party Sales by the Transmission

Provider) **[30,518]** exceeds its firm reserved capacity at any Point of Receipt or Point of Delivery.

13.8 Scheduling of Firm Point-To-Point Transmission Service: Schedules for the Transmission Customer's Firm Point-To-Point Transmission Service must be submitted to the Transmission Provider no later than 10:00 a.m. [or a reasonable time that is generally accepted in the region and is consistently adhered to by the Transmission Provider] of the day prior to commencement of such service. Schedules submitted after 10:00 a.m. will be accommodated, if practicable. Hour-to-hour schedules of any capacity and energy that is to be delivered must be stated in increments of 1,000 kW per hour [or a reasonable increment that is generally accepted in the region and is consistently adhered to by the Transmission Provider]. Transmission Customers within the Transmission Provider's service area with multiple requests for Transmission Service at a Point of Receipt, each of which is under 1,000 kW per hour, may consolidate their service requests at a common point of receipt into units of 1,000 kW per hour for scheduling and billing purposes. Scheduling changes will be permitted up to twenty (20) minutes [or a reasonable time that is generally accepted in the region and is consistently adhered to by the Transmission Provider] before the start of the next clock hour provided that the Delivering Party and Receiving Party also agree to the schedule modification. The Transmission Provider will furnish to the Delivering Party's system operator, hour-to-hour schedules equal to those furnished by the Receiving Party (unless reduced for losses) and shall deliver the capacity and energy provided by such schedules. Should the Transmission Customer, Delivering Party or Receiving Party revise or terminate any schedule, such party shall immediately

notify the Transmission Provider, and the Transmission Provider shall have the right to adjust accordingly the schedule for capacity and energy to be received and to be delivered.

14 *Nature of Non-Firm Point-To-Point Transmission Service*

14.1 Term: Non-Firm Point-To-Point Transmission Service will be available for periods ranging from one (1) hour to one (1) month. However, a Purchaser of Non-Firm Point-To-Point Transmission Service will be entitled to reserve a sequential term of service (such as a sequential monthly term without having to wait for the initial term to expire before requesting another monthly term) so that the total time period for which the reservation applies is greater than one month, subject to the requirements of Section 18.3.

14.2 Reservation Priority: Non-Firm Point-To-Point Transmission Service shall be available from transmission capability in excess of that needed for reliable service to Native Load Customers, Network Customers and other Transmission Customers taking Long- Term and Short-Term Firm Point-To-Point Transmission Service. A higher priority will be assigned to reservations with a longer duration of service. In the event the Transmission System is constrained, competing requests of equal duration will be prioritized based on the highest price offered by the Eligible Customer for the Transmission Service. Eligible Customers that have already reserved shorter term service have the right of first refusal to match any longer term reservation before being preempted. A longer term competing request for Non-Firm Point-To-Point Transmission Service will be granted if the Eligible Customer with the right of first refusal does not agree to match the

competing request: (a) immediately for hourly Non-Firm Point-To-Point Transmission Service after notification by the Transmission Provider; and, (b) within 24 hours (or earlier if necessary to comply with the scheduling deadlines provided in section 14.6) for Non-Firm Point-To-Point Transmission Service other than hourly transactions after notification by the Transmission Provider. Transmission service for Network Customers from resources other than designated Network Resources will have a higher priority than any Non-Firm Point-To-Point Transmission Service. Non-Firm Point-To-Point Transmission Service over secondary Point(s) of Receipt and Point(s) of Delivery will have the lowest reservation priority under the Tariff.

14.3 Use of Non-Firm Point-To-Point Transmission Service by the [30,519] Transmission Provider: The Transmission Provider will be subject to the rates, terms and conditions of Part II of the Tariff when making Third-Party Sales under (i) agreements executed on or after [insert date (Name of Transmission Provider) Open Access Transmission Tariff Original Sheet No. 48 sixty (60) days after publication in Federal Register] or (ii) agreements executed prior to the aforementioned date that the Commission requires to be unbundled, by the date specified by the Commission. The Transmission Provider will maintain separate accounting, pursuant to Section 8, for any use of Non-Firm Point-To-Point Transmission Service to make Third-Party Sales.

14.4 Service Agreements: The Transmission Provider shall offer a standard form Non-Firm Point-To-Point Transmission Service Agreement (Attachment B) to an Eligible Customer when it first submits a Completed Application for Non-Firm Point-To-Point Transmission

Service pursuant to the Tariff. Executed Service Agreements that contain the information required under the Tariff shall be filed with the Commission in compliance with applicable Commission regulations.

14.5 Classification of Non-Firm Point-To-Point Transmission Service: Non-Firm Point-To-Point Transmission Service shall be offered under terms and conditions contained in Part II of the Tariff. The Transmission Provider undertakes no obligation under the Tariff to plan its Transmission System in order to have sufficient capacity for Non-Firm Point-To-Point Transmission Service. Parties requesting Non-Firm Point-To-Point Transmission Service for the transmission of firm power do so with the full realization that such service is subject to availability and to Curtailment or Interruption under the terms of the Tariff. The Transmission Provider shall specify the rate treatment and all related terms and conditions applicable in the event that a Transmission Customer (including Third- Party Sales by the Transmission Provider) exceeds its non-firm capacity reservation. Non-Firm Point-To-Point Transmission Service shall include transmission of energy on an hourly basis and transmission of scheduled short-term capacity and energy on a daily, weekly or monthly basis, but not to exceed one month's reservation for any one Application, under Schedule 8.

14.6 Scheduling of Non-Firm Point-To-Point Transmission Service: Schedules for Non-Firm Point-To-Point Transmission Service must be submitted to the Transmission Provider no later than *2:00 p.m.* [or a reasonable time that is generally accepted in the region and is consistently adhered to by the Transmission Provider] of the

day prior to commencement of such service. Schedules submitted after 2:00 p.m. will be accommodated, if practicable. Hour-to-hour schedules of energy that is to be delivered must be stated in increments of 1,000 kW per hour [or a reasonable increment that is generally accepted in the region and is consistently adhered to by the Transmission Provider]. Transmission Customers within the Transmission Provider's service area with multiple requests for Transmission Service at a Point of Receipt, each of which is under 1,000 kW per hour, may consolidate their schedules at a common Point of Receipt into units of 1,000 kW per hour. Scheduling changes will be permitted up to *twenty (20) minutes* [or a reasonable time that is generally accepted in the region and is consistently adhered to by the Transmission Provider] before the start of the next clock hour provided that the Delivering Party and Receiving Party also agree to the schedule modification. The Transmission Provider will furnish to the Delivering Party's system operator, hour-to-hour schedules equal to those furnished by the Receiving Party (unless reduced for losses) and shall deliver the capacity and energy provided by such schedules. Should the Transmission Customer, Delivering Party or Receiving Party revise or terminate any schedule, such party shall immediately notify the Transmission Provider, and the Transmission Provider shall have the right to adjust accordingly the schedule for capacity and energy to be received and to be delivered.

14.7 Curtailment or Interruption of Service: The Transmission Provider reserves the right to Curtail, in whole or in part, Non-Firm Point-To-Point Transmission Service provided under the Tariff for reliability reasons when, an emergency or other unforeseen condition threatens to impair

or degrade **[30,520]** the reliability of its Transmission System. The Transmission Provider reserves the right to Interrupt, in whole or in part, Non-Firm Point-To-Point Transmission Service provided under the Tariff for economic reasons in order to accommodate (1) a request for Firm Transmission Service, (2) a request for Non- Firm Point-To-Point Transmission Service of greater duration, (3) a request for Non-Firm Point-To-Point Transmission Service of equal duration with a higher price, or (4) transmission service for Network Customers from non-designated resources. The Transmission Provider also will discontinue or reduce service to the Transmission Customer to the extent that deliveries for transmission are discontinued or reduced at the Point(s) of Receipt. Where required, Curtailments or Interruptions will be made on a non- discriminatory basis to the transaction(s) that effectively relieve the constraint, however, Non-Firm Point-To-Point Transmission Service shall be subordinate to Firm Transmission Service. If multiple transactions require Curtailment or Interruption, to the extent practicable and consistent with Good Utility Practice, Curtailments or Interruptions will be made to transactions of the shortest term (*e.g.*, hourly non- firm transactions will be Curtailed or Interrupted before daily non-firm transactions and daily non-firm transactions will be Curtailed or Interrupted before weekly non-firm transactions). Transmission service for Network Customers from resources other than designated Network Resources will have a higher priority than any Non-Firm Point-To-Point Transmission Service under the Tariff. Non-Firm Point-To-Point Transmission Service over secondary Point(s) of Receipt and Point(s) of Delivery will have a lower priority than any Non-Firm Point-To-Point Transmission Service under the Tariff. The Transmission Provider will provide advance notice of Curtailment or

Interruption where such notice can be provided consistent with Good Utility Practice.

15 *Service Availability*

15.1 General Conditions: The Transmission Provider will provide Firm and Non-Firm Point-To-Point Transmission Service over, on or across its Transmission System to any Transmission Customer that has met the requirements of Section 16.

15.2 Determination of Available Transmission Capability: A description of the Transmission Provider's specific methodology for assessing available transmission capability posted on the Transmission Provider's OASIS (Section 4) is contained in Attachment C of the Tariff. In the event sufficient transmission capability may not exist to accommodate a service request, the Transmission Provider will respond by performing a System Impact Study.

15.3 Initiating Service in the Absence of an Executed Service Agreement: If the Transmission Provider and the Transmission Customer requesting Firm or Non-Firm Point-To-Point Transmission Service cannot agree on all the terms and conditions of the Point-To-Point Service Agreement, the Transmission Provider shall file with the Commission, within thirty (30) days after the date the Transmission Customer provides written notification directing the Transmission Provider to file, an unexecuted Point-To-Point Service Agreement containing terms and conditions deemed appropriate by the Transmission Provider for such requested Transmission Service. The Transmission Provider shall commence providing Transmission Service subject to the

Transmission Customer agreeing to (i) compensate the Transmission Provider at whatever rate the Commission ultimately determines to be just and reasonable, and (ii) comply with the terms and conditions of the Tariff including posting appropriate security deposits in accordance with the terms of Section 17.3.

15.4 Obligation to Provide Transmission Service that Requires Expansion or Modification of the Transmission System: If the Transmission Provider determines that it cannot accommodate a Completed Application for Firm Point-To-Point Transmission Service because of insufficient capability on its Transmission System, the Transmission Provider will use due diligence to expand or modify its Transmission System to provide the requested Firm Transmission Service, provided the Transmission Customer agrees to compensate the Transmission **[30,521]** Provider for such costs pursuant to the terms of Section 27. The Transmission Provider will conform to Good Utility Practice in determining the need for new facilities and in the design and construction of such facilities. The obligation applies only to those facilities that the Transmission Provider has the right to expand or modify.

15.5 Deferral of Service: The Transmission Provider may defer providing service until it completes construction of new transmission facilities or upgrades needed to provide Firm Point-To-Point Transmission Service whenever the Transmission Provider determines that providing the requested service would, without such new facilities or upgrades, impair or degrade reliability to any existing firm services.

15.6 Other Transmission Service Schedules: Eligible Customers receiving transmission service under other agreements on file with the Commission may continue to receive transmission service under those agreements until such time as those agreements may be modified by the Commission.

15.7 Real Power Losses: Real Power Losses are associated with all transmission service. The Transmission Provider is not obligated to provide Real Power Losses. The Transmission Customer is responsible for replacing losses associated with all transmission service as calculated by the Transmission Provider. The applicable Real Power Loss factors are as follows: [To be completed by the Transmission Provider].

16 *Transmission Customer Responsibilities*

16.1 Conditions Required of Transmission Customers: Point-To-Point Transmission Service shall be provided by the Transmission Provider only if the following conditions are satisfied by the Transmission Customer:

a. The Transmission Customer has pending a Completed Application for service;

b. The Transmission Customer meets the creditworthiness criteria set forth in Section 11;

c. The Transmission Customer will have arrangements in place for any other transmission service necessary to effect the delivery from the generating source to

the Transmission Provider prior to the time service under Part II of the Tariff commences;

d. The Transmission Customer agrees to pay for any facilities constructed and chargeable to such Transmission Customer under Part II of the Tariff, whether or not the Transmission Customer takes service for the full term of its reservation; and

e. The Transmission Customer has executed a Point-To- Point Service Agreement or has agreed to receive service pursuant to Section 15.3.

16.2 Transmission Customer Responsibility for Third-Party Arrangements: Any scheduling arrangements that may be required by other electric systems shall be the responsibility of the Transmission Customer requesting service. The Transmission Customer shall provide, unless waived by the Transmission Provider, notification to the Transmission Provider identifying such systems and authorizing them to schedule the capacity and energy to be transmitted by the Transmission Provider pursuant to Part II of the Tariff on behalf of the Receiving Party at the Point of Delivery or the Delivering Party at the Point of Receipt. However, the Transmission Provider will undertake reasonable efforts to assist the Transmission Customer in making such arrangements, including without limitation, providing any information or data required by such other electric system pursuant to Good Utility Practice.

17 *Procedures for Arranging Firm Point-To-Point Transmission Service*

17.1 Application: A request for Firm Point-To-Point Transmission Service for periods of one year or longer must contain a written Application to: [Transmission Provider Name and Address], at least sixty (60) days in advance of the calendar month in which service is to commence. The Transmission Provider will consider requests for such firm service on shorter notice when feasible. Requests for firm service for periods of less than one year shall be subject to expedited procedures that shall be negotiated between the Parties within the time constraints provided in Section 17.5. All Firm Point-To-Point Transmission Service requests should **[30,522]** be submitted by entering the information listed below on the Transmission Provider's OASIS. Prior to implementation of the Transmission Provider's OASIS, a Completed Application may be submitted by (i) transmitting the required information to the Transmission Provider by telefax, or (ii) providing the information by telephone over the Transmission Provider's time recorded telephone line. Each of these methods will provide a time-stamped record for establishing the priority of the Application.

17.2 Completed Application: A Completed Application shall provide all of the information included in 18 CFR 2.20 including but not limited to the following:

(i) The identity, address, telephone number and facsimile number of the entity requesting service;

(ii) A statement that the entity requesting service is, or will be upon commencement of service, an Eligible Customer under the Tariff;

(iii) The location of the Point(s) of Receipt and Point(s) of Delivery and the identities of the Delivering Parties and the Receiving Parties;

(iv) The location of the generating facility(ies) supplying the capacity and energy and the location of the load ultimately served by the capacity and energy transmitted. The Transmission Provider will treat this information as confidential except to the extent that disclosure of this information is required by this Tariff, by regulatory or judicial order, for reliability purposes pursuant to Good Utility Practice or pursuant to RTG transmission information sharing agreements. The Transmission Provider shall treat this information consistent with the standards of conduct contained in Part 37 of the Commission's regulations;

(v) A description of the supply characteristics of the capacity and energy to be delivered;

(vi) An estimate of the capacity and energy expected to be delivered to the Receiving Party;

(vii) The Service Commencement Date and the term of the requested Transmission Service; and

(viii) The transmission capacity requested for each Point of Receipt and each Point of Delivery on the Transmission Provider's Transmission System; customers may combine their requests for service in order to satisfy the

minimum transmission capacity requirement. The Transmission Provider shall treat this information consistent with the standards of conduct contained in Part 37 of the Commission's regulations.

17.3 Deposit: A Completed Application for Firm Point-To-Point Transmission Service also shall include a deposit of either one month's charge for Reserved Capacity or the full charge for Reserved Capacity for service requests of less than one month. If the Application is rejected by the Transmission Provider because it does not meet the conditions for service as set forth herein, or in the case of requests for service arising in connection with losing bidders in a Request For Proposals (RFP), said deposit shall be returned with interest less any reasonable costs incurred by the Transmission Provider in connection with the review of the losing bidder's Application. The deposit also will be returned with interest less any reasonable costs incurred by the Transmission Provider if the Transmission Provider is unable to complete new facilities needed to provide the service. If an Application is withdrawn or the Eligible Customer decides not to enter into a Service Agreement for Firm Point-To-Point Transmission Service, the deposit shall be refunded in full, with interest, less reasonable costs incurred by the Transmission Provider to the extent such costs have not already been recovered by the Transmission Provider from the Eligible Customer. The Transmission Provider will provide to the Eligible Customer a complete accounting of all costs deducted from the refunded deposit, which the Eligible Customer may contest if there is a dispute concerning the deducted costs. Deposits associated with construction of new facilities are subject to the provisions of Section 19. If a Service Agreement for Firm Point-To-Point Transmission

Service is executed, the deposit, with interest, will be returned to the Transmission Customer upon expiration **[30,523]** or termination of the Service Agreement for Firm Point-To-Point Transmission Service. Applicable interest shall be computed in accordance with the Commission's regulations at 18 CFR §35.19a(a)(2)(iii), and shall be calculated from the day the deposit check is credited to the Transmission Provider's account.

17.4 Notice of Deficient Application: If an Application fails to meet the requirements of the Tariff, the Transmission Provider shall notify the entity requesting service within fifteen (15) days of receipt of the reasons for such failure. The Transmission Provider will attempt to remedy minor deficiencies in the Application through informal communications with the Eligible Customer. If such efforts are unsuccessful, the Transmission Provider shall return the Application, along with any deposit, with interest. Upon receipt of a new or revised Application that fully complies with the requirements of Part II of the Tariff, the Eligible Customer shall be assigned a new priority consistent with the date of the new or revised Application.

17.5 Response to a Completed Application: Following receipt of a Completed Application for Firm Point-To-Point Transmission Service, the Transmission Provider shall make a determination of available transmission capability as required in Section 15.2. The Transmission Provider shall notify the Eligible Customer as soon as practicable, but not later than thirty (30) days after the date of receipt of a Completed Application either (i) if it will be able to provide service without performing a System Impact Study or (ii) if such a study is needed to evaluate the impact of the

Application pursuant to Section 19.1. Responses by the Transmission Provider must be made as soon as practicable to all completed applications (including applications by its own merchant function) and the timing of such responses must be made on a non-discriminatory basis.

17.6 Execution of Service Agreement: Whenever the Transmission Provider determines that a System Impact Study is not required and that the service can be provided, it shall notify the Eligible Customer as soon as practicable but no later than thirty (30) days after receipt of the Completed Application. Where a System Impact Study is required, the provisions of Section 19 will govern the execution of a Service Agreement. Failure of an Eligible Customer to execute and return the Service Agreement or request the filing of an unexecuted service agreement pursuant to Section 15.3, within fifteen (15) days after it is tendered by the Transmission Provider will be deemed a withdrawal and termination of the Application and any deposit submitted shall be refunded with interest. Nothing herein limits the right of an Eligible Customer to file another Application after such withdrawal and termination.

17.7 Extensions for Commencement of Service: The Transmission Customer can obtain up to *five (5) one-year extensions* for the commencement of service. The Transmission Customer may postpone service by paying a non-refundable annual reservation fee equal to one- month's charge for Firm Transmission Service for each year or fraction thereof. If during any extension for the commencement of service an Eligible Customer submits a Completed Application for Firm Transmission Service, and such request can be satisfied only by releasing all or part of

the Transmission Customer's Reserved Capacity, the original Reserved Capacity will be released unless the following condition is satisfied. Within thirty (30) days, the original Transmission Customer agrees to pay the Firm Point-To-Point transmission rate for its Reserved Capacity concurrent with the new Service Commencement Date. In the event the Transmission Customer elects to release the Reserved Capacity, the reservation fees or portions thereof previously paid will be forfeited.

18 ***Procedures for Arranging Non-Firm Point-To-Point Transmission Service***

18.1 Application: Eligible Customers seeking Non-Firm Point-To-Point Transmission Service must submit a Completed Application to the Transmission Provider. Applications should be submitted by entering the information listed below on the Transmission Provider's OASIS. Prior to implementation of the Transmission Provider's OASIS, a Completed Application may be submitted by (i) transmitting the required **[30,524]** information to the Transmission Provider by telefax, or (ii) providing the information by telephone over the Transmission Provider's time recorded telephone line. Each of these methods will provide a time-stamped record for establishing the service priority of the Application.

18.2 Completed Application: A Completed Application shall provide all of the information included in 18 CFR §2.20 including but not limited to the following:

(i) The identity, address, telephone number and facsimile number of the entity requesting service;

(ii) A statement that the entity requesting service is, or will be upon commencement of service, an Eligible Customer under the Tariff;

(iii) The Point(s) of Receipt and the Point(s) of Delivery;

(iv) The maximum amount of capacity requested at each Point of Receipt and Point of Delivery; and

(v) The proposed dates and hours for initiating and terminating transmission service hereunder.

In addition to the information specified above, when required to properly evaluate system conditions, the Transmission Provider also may ask the Transmission Customer to provide the following:

(vi) The electrical location of the initial source of the power to be transmitted pursuant to the Transmission Customer's request for service; and

(vii) The electrical location of the ultimate load.

The Transmission Provider will treat this information in (vi) and (vii) as confidential at the request of the Transmission Customer except to the extent that disclosure of this information is required by this Tariff, by regulatory or judicial order, for reliability purposes pursuant to Good Utility Practice, or pursuant to RTG transmission information sharing agreements. The Transmission Provider shall treat this information consistent with the standards of conduct contained in Part 37 of the Commission's regulations.

18.3 Reservation of Non-Firm Point-To-Point Transmission Service: Requests for monthly service shall be submitted *no earlier than sixty (60) days* before service is to commence; requests for weekly service shall be submitted *no earlier than fourteen (14) days* before service is to commence, requests for daily service shall be submitted *no earlier than two (2) days* before service is to commence, and requests for hourly service shall be submitted *no earlier than noon the day* before service is to commence. Requests for service received later than *2:00 p.m.* prior to the day service is scheduled to commence will be accommodated if practicable [or such reasonable times that are generally accepted in the region and are consistently adhered to by the Transmission Provider].

18.4 Determination of Available Transmission Capability: Following receipt of a tendered schedule the Transmission Provider will make a determination on a non-discriminatory basis of available transmission capability pursuant to Section 15.2. Such determination shall be made as soon as reasonably practicable after receipt, but not later than the following time periods for the following terms of service *(i) thirty (30) minutes for hourly service, (ii) thirty (30) minutes for daily service, (iii) four (4) hours for weekly service, and (iv) two (2) days for monthly service.* [Or such reasonable times that are generally accepted in the region and are consistently adhered to by the Transmission Provider].

19 *Additional Study Procedures For Firm Point-To-Point Transmission Service Requests*

19.1 Notice of Need for System Impact Study: After receiving a request for service, the Transmission Provider shall determine on a non-discriminatory basis whether a

System Impact Study is needed. A description of the Transmission Provider's methodology for completing a System Impact Study is provided in Attachment D. If the Transmission Provider determines that a System Impact Study is necessary to accommodate the requested service, it shall so inform the Eligible Customer, as soon as practicable. In such cases, the Transmission Provider shall within thirty (30) days of receipt of a Completed Application, tender a System Impact Study Agreement pursuant to which the Eligible Customer shall agree **[30,525]** to reimburse the Transmission Provider for performing the required System Impact Study. For a service request to remain a Completed Application, the Eligible Customer shall execute the System Impact Study Agreement and return it to the Transmission Provider within fifteen (15) days. If the Eligible Customer elects not to execute the System Impact Study Agreement, its application shall be deemed withdrawn and its deposit, pursuant to Section 17.3, shall be returned with interest.

19.2 System Impact Study Agreement and Cost Reimbursement:

(i) The System Impact Study Agreement will clearly specify the Transmission Provider's estimate of the actual cost, and time for completion of the System Impact Study. The charge shall not exceed the actual cost of the study. In performing the System Impact Study, the Transmission Provider shall rely, to the extent reasonably practicable, on existing transmission planning studies. The Eligible Customer will not be assessed a charge for such existing studies; however, the Eligible Customer will be responsible for charges associated with any modifications to existing planning studies that are reasonably necessary to

evaluate the impact of the Eligible Customer's request for service on the Transmission System.

(ii) If in response to multiple Eligible Customers requesting service in relation to the same competitive solicitation, a single System Impact Study is sufficient for the Transmission Provider to accommodate the requests for service, the costs of that study shall be pro-rated among the Eligible Customers.

(iii) For System Impact Studies that the Transmission Provider conducts on its own behalf, the Transmission Provider shall record the cost of the System Impact Studies pursuant to Section 20.

19.3 System Impact Study Procedures: Upon receipt of an executed System Impact Study Agreement, the Transmission Provider will use due diligence to complete the required System Impact Study within a sixty (60) day period. The System Impact Study shall identify any system constraints and redispatch options, additional Direct Assignment Facilities or Network Upgrades required to provide the requested service. In the event that the Transmission Provider is unable to complete the required System Impact Study within such time period, it shall so notify the Eligible Customer and provide an estimated completion date along with an explanation of the reasons why additional time is required to complete the required studies. A copy of the completed System Impact Study and related work papers shall be made available to the Eligible Customer. The Transmission Provider will use the same due diligence in completing the System Impact Study for an Eligible Customer as it uses when completing studies for itself. The Transmission Provider shall

notify the Eligible Customer immediately upon completion of the System Impact Study if the Transmission System will be adequate to accommodate all or part of a request for service or that no costs are likely to be incurred for new transmission facilities or upgrades. In order for a request to remain a Completed Application, within fifteen (15) days of completion of the System Impact Study the Eligible Customer must execute a Service Agreement or request the filing of an unexecuted Service Agreement pursuant to Section 15.3, or the Application shall be deemed terminated and withdrawn.

19.4 Facilities Study Procedures: If a System Impact Study indicates that additions or upgrades to the Transmission System are needed to supply the Eligible Customer's service request, the Transmission Provider, within thirty (30) days of the completion of the System Impact Study, shall tender to the Eligible Customer a Facilities Study Agreement pursuant to which the Eligible Customer shall agree to reimburse the Transmission Provider for performing the required Facilities Study. For a service request to remain a Completed Application, the Eligible Customer shall execute the Facilities Study Agreement and return it to the Transmission Provider within fifteen (15) days. If the Eligible Customer elects not to execute the Facilities Study Agreement, its application shall be deemed withdrawn and its deposit, pursuant to Section 17.3, shall be returned **[30,526]** with interest. Upon receipt of an executed Facilities Study Agreement, the Transmission Provider will use due diligence to complete the required Facilities Study within a sixty (60) day period. If the Transmission Provider is unable to complete the Facilities Study in the allotted time period, the Transmission Provider shall notify the Transmission Customer and provide an estimate of the time needed to reach a final determination

along with an explanation of the reasons that additional time is required to complete the study. When completed, the Facilities Study will include a good faith estimate of (i) the cost of Direct Assignment Facilities to be charged to the Transmission Customer, (ii) the Transmission Customer's appropriate share of the cost of any required Network Upgrades as determined pursuant to the provisions of Part II of the Tariff, and (iii) the time required to complete such construction and initiate the requested service. The Transmission Customer shall provide the Transmission Provider with a letter of credit or other reasonable form of security acceptable to the Transmission Provider equivalent to the costs of new facilities or upgrades consistent with commercial practices as established by the Uniform Commercial Code. The Transmission Customer shall have thirty (30) days to execute a Service Agreement or request the filing of an unexecuted Service Agreement and provide the required letter of credit or other form of security or the request will no longer be a Completed Application and shall be deemed terminated and withdrawn.

19.5 Facilities Study Modifications: Any change in design arising from inability to site or construct facilities as proposed will require development of a revised good faith estimate. New good faith estimates also will be required in the event of new statutory or regulatory requirements that are effective before the completion of construction or other circumstances beyond the control of the Transmission Provider that significantly affect the final cost of new facilities or upgrades to be charged to the Transmission Customer pursuant to the provisions of Part II of the Tariff.

19.6 Due Diligence in Completing New Facilities: The Transmission Provider shall use due diligence to add necessary facilities or upgrade its Transmission System within a reasonable time. The Transmission Provider will not upgrade its existing or planned Transmission System in order to provide the requested Firm Point-To-Point Transmission Service if doing so would impair system reliability or otherwise impair or degrade existing firm service.

19.7 Partial Interim Service: If the Transmission Provider determines that it will not have adequate transmission capability to satisfy the full amount of a Completed Application for Firm Point-To-Point Transmission Service, the Transmission Provider nonetheless shall be obligated to offer and provide the portion of the requested Firm Point-To-Point Transmission Service that can be accommodated without addition of any facilities and through redispatch. However, the Transmission Provider shall not be obligated to provide the incremental amount of requested Firm Point-To-Point Transmission Service that requires the addition of facilities or upgrades to the Transmission System until such facilities or upgrades have been placed in service.

19.8 Expedited Procedures for New Facilities: In lieu of the procedures set forth above, the Eligible Customer shall have the option to expedite the process by requesting the Transmission Provider to tender at one time, together with the results of required studies, an "Expedited Service Agreement" pursuant to which the Eligible Customer would agree to compensate the Transmission Provider for all costs incurred pursuant to the terms of the Tariff. In order to exercise this option, the Eligible Customer shall request in writing an expedited Service Agreement covering all of the above-

specified items within thirty (30) days of receiving the results of the System Impact Study identifying needed facility additions or upgrades or costs incurred in providing the requested service. While the Transmission Provider agrees to provide the Eligible Customer with its best estimate of the new facility costs and other charges that may be incurred, such estimate shall not be binding and the Eligible Customer must agree in writing to compensate the Transmission Provider **[30,527]** for all costs incurred pursuant to the provisions of the Tariff. The Eligible Customer shall execute and return such an Expedited Service Agreement within fifteen (15) days of its receipt or the Eligible Customer's request for service will cease to be a Completed Application and will be deemed terminated and withdrawn.

20 Procedures if The Transmission Provider is Unable to Complete New Transmission Facilities for Firm Point-To-Point Transmission Service

20.1 Delays in Construction of New Facilities: If any event occurs that will materially affect the time for completion of new facilities, or the ability to complete them, the Transmission Provider shall promptly notify the Transmission Customer. In such circumstances, the Transmission Provider shall within thirty (30) days of notifying the Transmission Customer of such delays, convene a technical meeting with the Transmission Customer to evaluate the alternatives available to the Transmission Customer. The Transmission Provider also shall make available to the Transmission Customer studies and work papers related to the delay, including all information that is in the possession of the Transmission Provider that is reasonably needed by the Transmission Customer to evaluate any alternatives.

20.2 Alternatives to the Original Facility Additions: When the review process of Section 20.1 determines that one or more alternatives exist to the originally planned construction project, the Transmission Provider shall present such alternatives for consideration by the Transmission Customer. If, upon review of any alternatives, the Transmission Customer desires to maintain its Completed Application subject to construction of the alternative facilities, it may request the Transmission Provider to submit a revised Service Agreement for Firm Point-To-Point Transmission Service. If the alternative approach solely involves Non-Firm Point-To-Point Transmission Service, the Transmission Provider shall promptly tender a Service Agreement for Non-Firm Point-To-Point Transmission Service providing for the service. In the event the Transmission Provider concludes that no reasonable alternative exists and the Transmission Customer disagrees, the Transmission Customer may seek relief under the dispute resolution procedures pursuant to Section 12 or it may refer the dispute to the Commission for resolution.

20.3 Refund Obligation for Unfinished Facility Additions: If the Transmission Provider and the Transmission Customer mutually agree that no other reasonable alternatives exist and the requested service cannot be provided out of existing capability under the conditions of Part II of the Tariff, the obligation to provide the requested Firm Point-To-Point Transmission Service shall terminate and any deposit made by the Transmission Customer shall be returned with interest pursuant to Commission regulations 35.19a(a)(2)(iii). However, the Transmission Customer shall be responsible for all prudently incurred costs by the Transmission Provider through the time construction was suspended.

21 *Provisions Relating to Transmission Construction and Services on the Systems of Other Utilities*

21.1 Responsibility for Third-Party System Additions: The Transmission Provider shall not be responsible for making arrangements for any necessary engineering, permitting, and construction of transmission or distribution facilities on the system(s) of any other entity or for obtaining any regulatory approval for such facilities. The Transmission Provider will undertake reasonable efforts to assist the Transmission Customer in obtaining such arrangements, including without limitation, providing any information or data required by such other electric system pursuant to Good Utility Practice.

21.2 Coordination of Third-Party System Additions: In circumstances where the need for transmission facilities or upgrades is identified pursuant to the provisions of Part II of the Tariff, and if such upgrades further require the addition of transmission facilities on other systems, the Transmission Provider shall have the right to coordinate construction on its own system with the construction required by others. The Transmission Provider, after consultation with the Transmission Customer and representatives of such **[50,528]** other systems, may defer construction of its new transmission facilities, if the new transmission facilities on another system cannot be completed in a timely manner. The Transmission Provider shall notify the Transmission Customer in writing of the basis for any decision to defer construction and the specific problems which must be resolved before it will initiate or resume construction of new facilities. Within sixty (60) days of receiving written notification by the Transmission Provider of its intent to defer construction pursuant to this

section, the Transmission Customer may challenge the decision in accordance with the dispute resolution procedures pursuant to Section 12 or it may refer the dispute to the Commission for resolution.

22 *Changes in Service Specifications*

22.1 Modifications On a Non-Firm Basis: The Transmission Customer taking Firm Point-To-Point Transmission Service may request the Transmission Provider to provide transmission service on a non-firm basis over Receipt and Delivery Points other than those specified in the Service Agreement ("Secondary Receipt and Delivery Points"), in amounts not to exceed its firm capacity reservation, without incurring an additional Non-Firm Point-To-Point Transmission Service charge or executing a new Service Agreement, subject to the following conditions.

(a) Service provided over Secondary Receipt and Delivery Points will be non-firm only, on an as- available basis and will not displace any firm or non-firm service reserved or scheduled by third-parties under the Tariff or by the Transmission Provider on behalf of its Native Load Customers.

(b) The sum of all Firm and non-firm Point-To-Point Transmission Service provided to the Transmission Customer at any time pursuant to this section shall not exceed the Reserved Capacity in the relevant Service Agreement under which such services are provided.

(c) The Transmission Customer shall retain its right to schedule Firm Point-To-Point Transmission Service

at the Receipt and Delivery Points specified in the relevant Service Agreement in the amount of its original capacity reservation.

(d) Service over Secondary Receipt and Delivery Points on a non-firm basis shall not require the filing of an Application for Non-Firm Point-To-Point Transmission Service under the Tariff. However, all other requirements of Part II of the Tariff (except as to transmission rates) shall apply to transmission service on a non-firm basis over Secondary Receipt and Delivery Points.

22.2 Modification On a Firm Basis: Any request by a Transmission Customer to modify Receipt and Delivery Points on a firm basis shall be treated as a new request for service in accordance with Section 17 hereof, except that such Transmission Customer shall not be obligated to pay any additional deposit if the capacity reservation does not exceed the amount reserved in the existing Service Agreement. While such new request is pending, the Transmission Customer shall retain its priority for service at the existing firm Receipt and Delivery Points specified in its Service Agreement.

23 ***Sale or Assignment of Transmission Service***

23.1 Procedures for Assignment or Transfer of Service: Subject to Commission approval of any necessary filings, a Transmission Customer may sell, assign, or transfer all or a portion of its rights under its Service Agreement, but only to another Eligible Customer (the Assignee). The Transmission Customer that sells, assigns or transfers its rights under its Service Agreement is hereafter referred to as the Reseller. Compensation to the Reseller shall not exceed

the higher of (i) the original rate paid by the Reseller, (ii) the Transmission Provider's maximum rate on file at the time of the assignment, or (iii) the Reseller's opportunity cost capped at the Transmission Provider's cost of expansion. If the Assignee does not request any change in the Point(s) of Receipt or the Point(s) of Delivery, or a change in any other term or condition set forth in the original Service Agreement, the Assignee will receive the same services as did the Reseller and the priority of service for the Assignee will be the same as that of the Reseller. A Reseller should notify the Transmission Provider as soon as possible after any assignment or transfer of service **[30,529]** occurs but in any event, notification must be provided prior to any provision of service to the Assignee. The Assignee will be subject to all terms and conditions of this Tariff. If the Assignee requests a change in service, the reservation priority of service will be determined by the Transmission Provider pursuant to Section 13.2.

23.2 Limitations on Assignment or Transfer of Service: If the Assignee requests a change in the Point(s) of Receipt or Point(s) of Delivery, or a change in any other specifications set forth in the original Service Agreement, the Transmission Provider will consent to such change subject to the provisions of the Tariff, provided that the change will not impair the operation and reliability of the Transmission Provider's generation, transmission, or distribution systems. The Assignee shall compensate the Transmission Provider for performing any System Impact Study needed to evaluate the capability of the Transmission System to accommodate the proposed change and any additional costs resulting from such change. The Reseller shall remain liable for the performance of all obligations under the Service Agreement, except as

specifically agreed to by the Parties through an amendment to the Service Agreement.

23.3 Information on Assignment or Transfer of Service: In accordance with Section 4, Resellers may use the Transmission Provider's OASIS to post transmission capacity available for resale.

24 *Metering and Power Factor Correction at Receipt and Delivery Points(s)*

24.1 Transmission Customer Obligations: Unless otherwise agreed, the Transmission Customer shall be responsible for installing and maintaining compatible metering and communications equipment to accurately account for the capacity and energy being transmitted under Part II of the Tariff and to communicate the information to the Transmission Provider. Such equipment shall remain the property of the Transmission Customer.

24.2 Transmission Provider Access to Metering Data: The Transmission Provider shall have access to metering data, which may reasonably be required to facilitate measurements and billing under the Service Agreement.

24.3 Power Factor: Unless otherwise agreed, the Transmission Customer is required to maintain a power factor within the same range as the Transmission Provider pursuant to Good Utility Practices. The power factor requirements are specified in the Service Agreement where applicable.

25 *Compensation for Transmission Service*

Rates for Firm and Non-Firm Point-To-Point Transmission Service are provided in the Schedules appended to the Tariff: Firm Point-To-Point Transmission Service (Schedule 7); and Non-Firm Point-To-Point Transmission Service (Schedule 8). The Transmission Provider shall use Part II of the Tariff to make its Third-Party Sales. The Transmission Provider shall account for such use at the applicable Tariff rates, pursuant to Section 8.

26 *Stranded Cost Recovery*

The Transmission Provider may seek to recover stranded costs from the Transmission Customer pursuant to this Tariff in accordance with the terms, conditions and procedures set forth in FERC Order No. 888. However, the Transmission Provider must separately file any specific proposed stranded cost charge under Section 205 of the Federal Power Act.

27 *Compensation for New Facilities and Redispatch Costs*

Whenever a System Impact Study performed by the Transmission Provider in connection with the provision of Firm Point-To-Point Transmission Service identifies the need for new facilities, the Transmission Customer shall be responsible for such costs to the extent consistent with Commission policy. Whenever a System Impact Study performed by the Transmission Provider identifies capacity constraints that may be relieved more economically by redispatching the Transmission Provider's resources than by building new facilities or upgrading existing facilities to

eliminate such constraints, the Transmission Customer shall be responsible for the redispatch costs to the extent consistent with Commission policy.

III. Network Integration Transmission Service

Preamble

[30,530]

The Transmission Provider will provide Network Integration Transmission Service pursuant to the applicable terms and conditions contained in the Tariff and Service Agreement. Network Integration Transmission Service allows the Network Customer to integrate, economically dispatch and regulate its current and planned Network Resources to serve its Network Load in a manner comparable to that in which the Transmission Provider utilizes its Transmission System to serve its Native Load Customers. Network Integration Transmission Service also may be used by the Network Customer to deliver economy energy purchases to its Network Load from non-designated resources on an as- available basis without additional charge. Transmission service for sales to non-designated loads will be provided pursuant to the applicable terms and conditions of Part II of the Tariff.

28 ***Nature of Network Integration Transmission Service***

28.1 Scope of Service: Network Integration Transmission Service is a transmission service that allows Network Customers to efficiently and economically utilize their Network Resources (as well as other non-designated generation resources) to serve their Network Load located in the Transmission Provider's Control Area and any additional

load that may be designated pursuant to Section 31.3 of the Tariff. The Network Customer taking Network Integration Transmission Service must obtain or provide Ancillary Services pursuant to Section 3.

28.2 Transmission Provider Responsibilities: The Transmission Provider will plan, construct, operate and maintain its Transmission System in accordance with Good Utility Practice in order to provide the Network Customer with Network Integration Transmission Service over the Transmission Provider's Transmission System. The Transmission Provider, on behalf of its Native Load Customers, shall be required to designate resources and loads in the same manner as any Network Customer under Part III of this Tariff. This information must be consistent with the information used by the Transmission Provider to calculate available transmission capability. The Transmission Provider shall include the Network Customer's Network Load in its Transmission System planning and shall, consistent with Good Utility Practice, endeavor to construct and place into service sufficient transmission capacity to deliver the Network Customer's Network Resources to serve its Network Load on a basis comparable to the Transmission Provider's delivery of its own generating and purchased resources to its Native Load Customers.

28.3 Network Integration Transmission Service: The Transmission Provider will provide firm transmission service over its Transmission System to the Network Customer for the delivery of capacity and energy from its designated Network Resources to service its Network Loads on a basis that is comparable to the Transmission Provider's use of the

Transmission System to reliably serve its Native Load Customers.

28.4 Secondary Service: The Network Customer may use the Transmission Provider's Transmission System to deliver energy to its Network Loads from resources that have not been designated as Network Resources. Such energy shall be transmitted, on an as-available basis, at no additional charge. Deliveries from resources other than Network Resources will have a higher priority than any Non-Firm Point-To-Point Transmission Service under Part II of the Tariff.

28.5 Real Power Losses: Real Power Losses are associated with all transmission service. The Transmission Provider is not obligated to provide Real Power Losses. The Network Customer is responsible for replacing losses associated with all transmission service as calculated by the Transmission Provider. The applicable Real Power Loss factors are as follows: [To be completed by the Transmission Provider].

28.6 Restrictions on Use of Service: The Network Customer shall not use Network Integration Transmission Service for (i) sales of capacity and energy to non-designated loads, or (ii) direct or indirect provision of transmission service by the Network Customer to third parties. All Network Customers taking Network Integration Transmission Service shall use Point-To-Point Transmission Service under Part II of the Tariff for any Third-Party Sale which requires **[30,531]** use of the Transmission Provider's Transmission System.

29 *Initiating Service*

29.1 Condition Precedent for Receiving Service: Subject to the terms and conditions of Part III of the Tariff, the Transmission Provider will provide Network Integration Transmission Service to any Eligible Customer, provided that (i) the Eligible Customer completes an Application for service as provided under Part III of the Tariff, (ii) the Eligible Customer and the Transmission Provider complete the technical arrangements set forth in Sections 29.3 and 29.4, (iii) the Eligible Customer executes a Service Agreement pursuant to Attachment F for service under Part III of the Tariff or requests in writing that the Transmission Provider file a proposed unexecuted Service Agreement with the Commission, and (iv) the Eligible Customer executes a Network Operating Agreement with the Transmission Provider pursuant to Attachment G.

29.2 Application Procedures: An Eligible Customer requesting service under Part III of the Tariff must submit an Application, with a deposit approximating the charge for one month of service, to the Transmission Provider as far as possible in advance of the month in which service is to commence. Unless subject to the procedures in Section 2, Completed Applications for Network Integration Transmission Service will be assigned a priority according to the date and time the Application is received, with the earliest Application receiving the highest priority. Applications should be submitted by entering the information listed below on the Transmission Provider's OASIS. Prior to implementation of the Transmission Provider's OASIS, a Completed Application may be submitted by (i) transmitting the required information to the Transmission Provider by telefax, or (ii) providing the

information by telephone over the Transmission Provider's time recorded telephone line. Each of these methods will provide a time-stamped record for establishing the service priority of the Application. A Completed Application shall provide all of the information included in 18 CFR §2.20 including but not limited to the following:

(i) The identity, address, telephone number and facsimile number of the party requesting service;

(ii) A statement that the party requesting service is, or will be upon commencement of service, an Eligible Customer under the Tariff;

(iii) A description of the Network Load at each delivery point. This description should separately identify and provide the Eligible Customer's best estimate of the total loads to be served at each transmission voltage level, and the loads to be served from each Transmission Provider substation at the same transmission voltage level. The description should include a ten (10) year forecast of summer and winter load and resource requirements beginning with the first year after the service is scheduled to commence;

(iv) The amount and location of any interruptible loads included in the Network Load. This shall include the summer and winter capacity requirements for each interruptible load (had such load not been interruptible), that portion of the load subject to interruption, the conditions under which an interruption can be implemented and any limitations on the amount and frequency of interruptions. An Eligible Customer should identify the amount of interruptible

customer load (if any) included in the 10 year load forecast provided in response to (iii) above;

(v) A description of Network Resources (current and 10-year projection), which shall include, for each Network Resource:

- Unit size and amount of capacity from that unit to be designated as Network Resource

- VAR capability (both leading and lagging) of all generators

- Operating restrictions

- Any periods of restricted operations throughout the year

- Maintenance schedules

- Minimum loading level of unit - Normal operating level of unit

- Any must-run unit designations required for system reliability or contract reasons

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- Approximate variable generating cost ($/MWH) for redispatch computations

- Arrangements governing sale and delivery of power to third parties from generating facilities located in the

Transmission Provider Control Area, where only a portion of unit output is designated as a Network Resource

- Description of purchased power designated as a Network Resource including source of supply, Control Area location, transmission arrangements and delivery point(s) to the Transmission Provider's Transmission System;

(vi) Description of Eligible Customer's transmission system:

- Load flow and stability data, such as real and reactive parts of the load, lines, transformers, reactive devices and load type, including normal and emergency ratings of all transmission equipment in a load flow format compatible with that used by the Transmission Provider

- Operating restrictions needed for reliability

- Operating guides employed by system operators

- Contractual restrictions or committed uses of the Eligible Customer's transmission system, other than the Eligible Customer's Network Loads and Resources

- Location of Network Resources described in subsection (v) above

- 10 year projection of system expansions or upgrades

- Transmission System maps that include any proposed expansions or upgrades

- Thermal ratings of Eligible Customer's Control Area ties with other Control Areas; and

(vii) Service Commencement Date and the term of the requested Network Integration Transmission Service. The minimum term for Network Integration Transmission Service is one year.

Unless the Parties agree to a different time frame, the Transmission Provider must acknowledge the request within ten (10) days of receipt. The acknowledgement must include a date by which a response, including a Service Agreement, will be sent to the Eligible Customer. If an Application fails to meet the requirements of this section, the Transmission Provider shall notify the Eligible Customer requesting service within fifteen (15) days of receipt and specify the reasons for such failure. Wherever possible, the Transmission Provider will attempt to remedy deficiencies in the Application through informal communications with the Eligible Customer. If such efforts are unsuccessful, the Transmission Provider shall return the Application without prejudice to the Eligible Customer filing a new or revised Application that fully complies with the requirements of this section. The Eligible Customer will be assigned a new priority consistent with the date of the new or revised Application. The Transmission Provider shall treat this information consistent with the standards of conduct contained in Part 37 of the Commission's regulations.

29.3 Technical Arrangements to be Completed Prior to Commencement of Service: Network Integration Transmission Service shall not commence until the Transmission Provider and the Network Customer, or a third party, have completed installation of all equipment specified under the Network Operating Agreement consistent with Good Utility Practice and any additional requirements reasonably and consistently imposed to ensure the reliable operation of the Transmission System. The Transmission Provider shall exercise reasonable efforts, in coordination with the Network Customer, to complete such arrangements as soon as practicable taking into consideration the Service Commencement Date.

29.4 Network Customer Facilities: The provision of Network Integration Transmission Service shall be conditioned upon the Network Customer's constructing, maintaining and operating the facilities on its side of each delivery point or interconnection necessary to reliably deliver capacity and energy from the Transmission Provider's Transmission System to the Network Customer. The Network Customer shall be solely responsible for constructing or installing all facilities on the Network Customer's side of each such delivery point or interconnection.

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29.5 Filing of Service Agreement: The Transmission Provider will file Service Agreements with the Commission in compliance with applicable Commission regulations.

30 *Network Resources*

30.1 Designation of Network Resources: Network Resources shall include all generation owned, purchased or leased by the Network Customer designated to serve Network Load under the Tariff. Network Resources may not include resources, or any portion thereof, that are committed for sale to non-designated third party load or otherwise cannot be called upon to meet the Network Customer's Network Load on a non-interruptible basis. Any owned or purchased resources that were serving the Network Customer's loads under firm agreements entered into on or before the Service Commencement Date shall initially be designated as Network Resources until the Network Customer terminates the designation of such resources.

30.2 Designation of New Network Resources: The Network Customer may designate a new Network Resource by providing the Transmission Provider with as much advance notice as practicable. A designation of a new Network Resource must be made by a request for modification of service pursuant to an Application under Section 29.

30.3 Termination of Network Resources: The Network Customer may terminate the designation of all or part of a generating resource as a Network Resource at any time but should provide notification to the Transmission Provider as soon as reasonably practicable.

30.4 Operation of Network Resources: The Network Customer shall not operate its designated Network Resources located in the Network Customer's or Transmission Provider's Control Area such that the output of those facilities

exceeds its designated Network Load, plus non-firm sales delivered pursuant to Part II of the Tariff, plus losses. This limitation shall not apply to changes in the operation of a Transmission Customer's Network Resources at the request of the Transmission Provider to respond to an emergency or other unforeseen condition which may impair or degrade the reliability of the Transmission System.

30.5 Network Customer Redispatch Obligation: As a condition to receiving Network Integration Transmission Service, the Network Customer agrees to redispatch its Network Resources as requested by the Transmission Provider pursuant to Section 33.2. To the extent practical, the redispatch of resources pursuant to this section shall be on a least cost, non-discriminatory basis between all Network Customers, and the Transmission Provider.

30.6 Transmission Arrangements for Network Resources Not Physically Interconnected With The Transmission Provider: The Network Customer shall be responsible for any arrangements necessary to deliver capacity and energy from a Network Resource not physically interconnected with the Transmission Provider's Transmission System. The Transmission Provider will undertake reasonable efforts to assist the Network Customer in obtaining such arrangements, including without limitation, providing any information or data required by such other entity pursuant to Good Utility Practice.

30.7 Limitation on Designation of Network Resources: The Network Customer must demonstrate that it owns or has committed to purchase generation pursuant to an executed contract in order to designate a generating resource

as a Network Resource. Alternatively, the Network Customer may establish that execution of a contract is contingent upon the availability of transmission service under Part III of the Tariff.

30.8 Use of Interface Capacity by the Network Customer: There is no limitation upon a Network Customer's use of the Transmission Provider's Transmission System at any particular interface to integrate the Network Customer's Network Resources (or substitute economy purchases) with its Network Loads. However, a Network Customer's use of the Transmission Provider's total interface capacity with other transmission systems may not exceed the Network Customer's Load.

30.9 Network Customer Owned Transmission Facilities: The Network **[30,534]** Customer that owns existing transmission facilities that are integrated with the Transmission Provider's Transmission System may be eligible to receive consideration either through a billing credit or some other mechanism. In order to receive such consideration the Network Customer must demonstrate that its transmission facilities are integrated into the plans or operations of the Transmission Provider to serve its power and transmission customers. For facilities constructed by the Network Customer subsequent to the Service Commencement Date under Part III of the Tariff, the Network Customer shall receive credit where such facilities are jointly planned and installed in coordination with the Transmission Provider. Calculation of the credit shall be addressed in either the Network Customer's Service Agreement or any other agreement between the Parties.

31 *Designation of Network Load*

31.1 Network Load: The Network Customer must designate the individual Network Loads on whose behalf the Transmission Provider will provide Network Integration Transmission Service. The Network Loads shall be specified in the Service Agreement.

31.2 New Network Loads Connected With the Transmission Provider: The Network Customer shall provide the Transmission Provider with as much advance notice as reasonably practicable of the designation of new Network Load that will be added to its Transmission System. A designation of new Network Load must be made through a modification of service pursuant to a new Application. The Transmission Provider will use due diligence to install any transmission facilities required to interconnect a new Network Load designated by the Network Customer. The costs of new facilities required to interconnect a new Network Load shall be determined in accordance with the procedures provided in Section 32.4 and shall be charged to the Network Customer in accordance with Commission policies.

31.3 Network Load Not Physically Interconnected with the Transmission Provider: This section applies to both initial designation pursuant to Section 31.1 and the subsequent addition of new Network Load not physically interconnected with the Transmission Provider. To the extent that the Network Customer desires to obtain transmission service for a load outside the Transmission Provider's Transmission System, the Network Customer shall have the option of (1) electing to include the entire load as Network Load for all purposes under Part III of the Tariff and designating Network

Resources in connection with such additional Network Load, or (2) excluding that entire load from its Network Load and purchasing Point-To-Point Transmission Service under Part II of the Tariff. To the extent that the Network Customer gives notice of its intent to add a new Network Load as part of its Network Load pursuant to this section the request must be made through a modification of service pursuant to a new Application.

31.4 New Interconnection Points: To the extent the Network Customer desires to add a new Delivery Point or interconnection point between the Transmission Provider's Transmission System and a Network Load, the Network Customer shall provide the Transmission Provider with as much advance notice as reasonably practicable.

31.5 Changes in Service Requests: Under no circumstances shall the Network Customer's decision to cancel or delay a requested change in Network Integration Transmission Service (*e.g.* the addition of a new Network Resource or designation of a new Network Load) in any way relieve the Network Customer of its obligation to pay the costs of transmission facilities constructed by the Transmission Provider and charged to the Network Customer as reflected in the Service Agreement. However, the Transmission Provider must treat any requested change in Network Integration Transmission Service in a non-discriminatory manner.

31.6 Annual Load and Resource Information Updates: The Network Customer shall provide the Transmission Provider with annual updates of Network Load and Network Resource forecasts consistent with those

included in its Application for Network Integration Transmission Service under Part III of the Tariff. The Network Customer **[30,535]** also shall provide the Transmission Provider with timely written notice of material changes in any other information provided in its Application relating to the Network Customer's Network Load, Network Resources, its transmission system or other aspects of its facilities or operations affecting the Transmission Provider's ability to provide reliable service.

32 *Additional Study Procedures For Network Integration Transmission Service Requests*

32.1 Notice of Need for System Impact Study: After receiving a request for service, the Transmission Provider shall determine on a non-discriminatory basis whether a System Impact Study is needed. A description of the Transmission Provider's methodology for completing a System Impact Study is provided in Attachment D. If the Transmission Provider determines that a System Impact Study is necessary to accommodate the requested service, it shall so inform the Eligible Customer, as soon as practicable. In such cases, the Transmission Provider shall within thirty (30) days of receipt of a Completed Application, tender a System Impact Study Agreement pursuant to which the Eligible Customer shall agree to reimburse the Transmission Provider for performing the required System Impact Study. For a service request to remain a Completed Application, the Eligible Customer shall execute the System Impact Study Agreement and return it to the Transmission Provider within fifteen (15) days. If the Eligible Customer elects not to execute the System Impact Study Agreement, its Application shall be deemed withdrawn and its deposit shall be returned with interest.

32.2 System Impact Study Agreement and Cost Reimbursement:

(i) The System Impact Study Agreement will clearly specify the Transmission Provider's estimate of the actual cost, and time for completion of the System Impact Study. The charge shall not exceed the actual cost of the study. In performing the System Impact Study, the Transmission Provider shall rely, to the extent reasonably practicable, on existing transmission planning studies. The Eligible Customer will not be assessed a charge for such existing studies; however, the Eligible Customer will be responsible for charges associated with any modifications to existing planning studies that are reasonably necessary to evaluate the impact of the Eligible Customer's request for service on the Transmission System.

(ii) If in response to multiple Eligible Customers requesting service in relation to the same competitive solicitation, a single System Impact Study is sufficient for the Transmission Provider to accommodate the service requests, the costs of that study shall be pro-rated among the Eligible Customers.

(iii) For System Impact Studies that the Transmission Provider conducts on its own behalf, the Transmission Provider shall record the cost of the System Impact Studies pursuant to Section 8.

32.3 System Impact Study Procedures: Upon receipt of an executed System Impact Study Agreement, the Transmission Provider will use due diligence to complete the required System Impact Study within a sixty (60) day period.

The System Impact Study shall identify any system constraints and redispatch options, additional Direct Assignment Facilities or Network Upgrades required to provide the requested service. In the event that the Transmission Provider is unable to complete the required System Impact Study within such time period, it shall so notify the Eligible Customer and provide an estimated completion date along with an explanation of the reasons why additional time is required to complete the required studies. A copy of the completed System Impact Study and related work papers shall be made available to the Eligible Customer. The Transmission Provider will use the same due diligence in completing the System Impact Study for an Eligible Customer as it uses when completing studies for itself. The Transmission Provider shall notify the Eligible Customer immediately upon completion of the System Impact Study if the Transmission System will be adequate to accommodate all or part of a request for service or that no costs are likely to be incurred for new transmission facilities or upgrades. In order for a request to **[30,536]** remain a Completed Application, within fifteen (15) days of completion of the System Impact Study the Eligible Customer must execute a Service Agreement or request the filing of an unexecuted Service Agreement, or the Application shall be deemed terminated and withdrawn.

32.4 Facilities Study Procedures: If a System Impact Study indicates that additions or upgrades to the Transmission System are needed to supply the Eligible Customer's service request, the Transmission Provider, within thirty (30) days of the completion of the System Impact Study, shall tender to the Eligible Customer a Facilities Study Agreement pursuant to which the Eligible Customer shall agree to reimburse the Transmission Provider for performing the required Facilities

Study. For a service request to remain a Completed Application, the Eligible Customer shall execute the Facilities Study Agreement and return it to the Transmission Provider within fifteen (15) days. If the Eligible Customer elects not to execute the Facilities Study Agreement, its Application shall be deemed withdrawn and its deposit shall be returned with interest. Upon receipt of an executed Facilities Study Agreement, the Transmission Provider will use due diligence to complete the required Facilities Study within a sixty (60) day period. If the Transmission Provider is unable to complete the Facilities Study in the allotted time period, the Transmission Provider shall notify the Eligible Customer and provide an estimate of the time needed to reach a final determination along with an explanation of the reasons that additional time is required to complete the study. When completed, the Facilities Study will include a good faith estimate of (i) the cost of Direct Assignment Facilities to be charged to the Eligible Customer, (ii) the Eligible Customer's appropriate share of the cost of any required Network Upgrades, and (iii) the time required to complete such construction and initiate the requested service. The Eligible Customer shall provide the Transmission Provider with a letter of credit or other reasonable form of security acceptable to the Transmission Provider equivalent to the costs of new facilities or upgrades consistent with commercial practices as established by the Uniform Commercial Code. The Eligible Customer shall have thirty (30) days to execute a Service Agreement or request the filing of an unexecuted Service Agreement and provide the required letter of credit or other form of security or the request no longer will be a Completed Application and shall be deemed terminated and withdrawn.

33 *Load Shedding and Curtailments*

33.1 Procedures: Prior to the Service Commencement Date, the Transmission Provider and the Network Customer shall establish Load Shedding and Curtailment procedures pursuant to the Network Operating Agreement with the objective of responding to contingencies on the Transmission System. The Parties will implement such programs during any period when the Transmission Provider determines that a system contingency exists and such procedures are necessary to alleviate such contingency. The Transmission Provider will notify all affected Network Customers in a timely manner of any scheduled Curtailment.

33.2 Transmission Constraints: During any period when the Transmission Provider determines that a transmission constraint exists on the Transmission System, and such constraint may impair the reliability of the Transmission Provider's system, the Transmission Provider will take whatever actions, consistent with Good Utility Practice, that are reasonably necessary to maintain the reliability of the Transmission Provider's system. To the extent the Transmission Provider determines that the reliability of the Transmission System can be maintained by redispatching resources, the Transmission Provider will initiate procedures pursuant to the Network Operating Agreement to redispatch all Network Resources and the Transmission Provider's own resources on a least-cost basis without regard to the ownership of such resources. Any redispatch under this section may not unduly discriminate between the Transmission Provider's use of the Transmission System on behalf of its Native Load Customers and any

Network Customer's use of the Transmission System to serve its designated Network Load.

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33.3 Cost Responsibility for Relieving Transmission Constraints: Whenever the Transmission Provider implements least-cost redispatch procedures in response to a transmission constraint, the Transmission Provider and Network Customers will each bear a proportionate share of the total redispatch cost based on their respective Load Ratio Shares.

33.4 Curtailments of Scheduled Deliveries: If a transmission constraint on the Transmission Provider's Transmission System cannot be relieved through the implementation of least-cost redispatch procedures and the Transmission Provider determines that it is necessary to Curtail scheduled deliveries, the Parties shall Curtail such schedules in accordance with the Network Operating Agreement.

33.5 Allocation of Curtailments: The Transmission Provider shall, on a non-discriminatory basis, Curtail the transaction(s) that effectively relieve the constraint. However, to the extent practicable and consistent with Good Utility Practice, any Curtailment will be shared by the Transmission Provider and Network Customer in proportion to their respective Load Ratio Shares. The Transmission Provider shall not direct the Network Customer to Curtail schedules to an extent greater than the Transmission Provider would Curtail the Transmission Provider's schedules under similar circumstances.

33.6 Load Shedding: To the extent that a system contingency exists on the Transmission Provider's Transmission System and the Transmission Provider determines that it is necessary for the Transmission Provider and the Network Customer to shed load, the Parties shall shed load in accordance with previously established procedures under the Network Operating Agreement.

33.7 System Reliability: Notwithstanding any other provisions of this Tariff, the Transmission Provider reserves the right, consistent with Good Utility Practice and on a not unduly discriminatory basis, to Curtail Network Integration Transmission Service without liability on the Transmission Provider's part for the purpose of making necessary adjustments to, changes in, or repairs on its lines, substations and facilities, and in cases where the continuance of Network Integration Transmission Service would endanger persons or property. In the event of any adverse condition(s) or disturbance(s) on the Transmission Provider's Transmission System or on any other system(s) directly or indirectly interconnected with the Transmission Provider's Transmission System, the Transmission Provider, consistent with Good Utility Practice, also may Curtail Network Integration Transmission Service in order to (i) limit the extent or damage of the adverse condition(s) or disturbance(s), (ii) prevent damage to generating or transmission facilities, or (iii) expedite restoration of service. The Transmission Provider will give the Network Customer as much advance notice as is practicable in the event of such Curtailment. Any Curtailment of Network Integration Transmission Service will be not unduly discriminatory relative to the Transmission Provider's use of the Transmission System on behalf of its Native Load Customers. The Transmission Provider shall specify the rate

treatment and all related terms and conditions applicable in the event that the Network Customer fails to respond to established Load Shedding and Curtailment procedures.

34 *Rates and Charges*

The Network Customer shall pay the Transmission Provider for any Direct Assignment Facilities, Ancillary Services, and applicable study costs, consistent with Commission policy, along with the following:

34.1 Monthly Demand Charge: The Network Customer shall pay a monthly Demand Charge, which shall be determined by multiplying its Load Ratio Share times one twelfth (1/12) of the Transmission Provider's Annual Transmission Revenue Requirement specified in Schedule H.

34.2 Determination of Network Customer's Monthly Network Load: The Network Customer's monthly Network Load is its hourly load (including its designated Network Load not physically interconnected with the Transmission Provider under Section 31.3) coincident with the Transmission Provider's Monthly Transmission System Peak.

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34.3 Determination of Transmission Provider's Monthly Transmission System Load: The Transmission Provider's monthly Transmission System load is the Transmission Provider's Monthly Transmission System Peak minus the coincident peak usage of all Firm Point-To-Point Transmission Service customers pursuant to Part II of this Tariff plus the Reserved Capacity of all Firm Point-To-Point Transmission Service customers.

34.4 Redispatch Charge: The Network Customer shall pay a Load Ratio Share of any redispatch costs allocated between the Network Customer and the Transmission Provider pursuant to Section 33. To the extent that the Transmission Provider incurs an obligation to the Network Customer for redispatch costs in accordance with Section 33, such amounts shall be credited against the Network Customer's bill for the applicable month.

34.5 Stranded Cost Recovery: The Transmission Provider may seek to recover stranded costs from the Network Customer pursuant to this Tariff in accordance with the terms, conditions and procedures set forth in FERC Order No. 888. However, the Transmission Provider must separately file any proposal to recover stranded costs under Section 205 of the Federal Power Act.

35 ***Operating Arrangements***

35.1 Operation under The Network Operating Agreement: The Network Customer shall plan, construct, operate and maintain its facilities in accordance with Good Utility Practice and in conformance with the Network Operating Agreement.

35.2 Network Operating Agreement: The terms and conditions under which the Network Customer shall operate its facilities and the technical and operational matters associated with the implementation of Part III of the Tariff shall be specified in the Network Operating Agreement. The Network Operating Agreement shall provide for the Parties to (i) operate and maintain equipment necessary for integrating the Network Customer within the Transmission Provider's

Transmission System (including, but not limited to, remote terminal units, metering, communications equipment and relaying equipment), (ii) transfer data between the Transmission Provider and the Network Customer (including, but not limited to, heat rates and operational characteristics of Network Resources, generation schedules for units outside the Transmission Provider's Transmission System, interchange schedules, unit outputs for redispatch required under Section 33, voltage schedules, loss factors and other real time data), (iii) use software programs required for data links and constraint dispatching, (iv) exchange data on forecasted loads and resources necessary for long-term planning, and (v) address any other technical and operational considerations required for implementation of Part III of the Tariff, including scheduling protocols. The Network Operating Agreement will recognize that the Network Customer shall either (i) operate as a Control Area under applicable guidelines of the North American Electric Reliability Council (NERC) and the [applicable regional reliability council], (ii) satisfy its Control Area requirements, including all necessary Ancillary Services, by contracting with the Transmission Provider, or (iii) satisfy its Control Area requirements, including all necessary Ancillary Services, by contracting with another entity, consistent with Good Utility Practice, which satisfies NERC and the [applicable regional reliability council] requirements. The Transmission Provider shall not unreasonably refuse to accept contractual arrangements with another entity for Ancillary Services. The Network Operating Agreement is included in Attachment G.

35.3 Network Operating Committee: A Network Operating Committee (Committee) shall be established to coordinate operating criteria for the Parties' respective

responsibilities under the Network Operating Agreement. Each Network Customer shall be entitled to have at least one representative on the Committee. The Committee shall meet from time to time as need requires, but no less than once each calendar year.

Schedule 1--Scheduling, System Control and Dispatch Service

This service is required to schedule the movement of power through, out of, **[30,539]** within, or into a Control Area. This service can be provided only by the operator of the Control Area in which the transmission facilities used for transmission service are located. Scheduling, System Control and Dispatch Service is to be provided directly by the Transmission Provider (if the Transmission Provider is the Control Area operator) or indirectly by the Transmission Provider making arrangements with the Control Area operator that performs this service for the Transmission Provider's Transmission System. The Transmission Customer must purchase this service from the Transmission Provider or the Control Area operator. The charges for Scheduling, System Control and Dispatch Service are to be based on the rates set forth below. To the extent the Control Area operator performs this service for the Transmission Provider, charges to the Transmission Customer are to reflect only a pass-through of the costs charged to the Transmission Provider by that Control Area operator.

Schedule 2--Reactive Supply and Voltage Control from Generation Sources Service

In order to maintain transmission voltages on the Transmission Provider's transmission facilities within acceptable limits, generation facilities under the control of the control area operator are operated to produce (or absorb) reactive power. Thus, Reactive Supply and Voltage Control from Generation Sources Service must be provided for each transaction on the Transmission Provider's transmission facilities. The amount of Reactive Supply and Voltage Control from Generation Sources Service that must be supplied with respect to the Transmission Customer's transaction will be determined based on the reactive power support necessary to maintain transmission voltages within limits that are generally accepted in the region and consistently adhered to by the Transmission Provider.

Reactive Supply and Voltage Control from Generation Sources Service is to be provided directly by the Transmission Provider (if the Transmission Provider is the Control Area operator) or indirectly by the Transmission Provider making arrangements with the Control Area operator that performs this service for the Transmission Provider's Transmission System. The Transmission Customer must purchase this service from the Transmission Provider or the Control Area operator. The charges for such service will be based on the rates set forth below. To the extent the Control Area operator performs this service for the Transmission Provider, charges to the Transmission Customer are to reflect only a pass-through of the costs charged to the Transmission Provider by the Control Area operator.

Schedule 3--Regulation and Frequency Response Service

Regulation and Frequency Response Service is necessary to provide for the continuous balancing of resources (generation and interchange) with load and for maintaining scheduled Interconnection frequency at sixty cycles per second (60 Hz). Regulation and Frequency Response Service is accomplished by committing on-line generation whose output is raised or lowered (predominantly through the use of automatic generating control equipment) as necessary to follow the moment-by-moment changes in load. The obligation to maintain this balance between resources and load lies with the Transmission Provider (or the Control Area operator that performs this function for the Transmission Provider). The Transmission Provider must offer this service when the transmission service is used to serve load within its Control Area. The Transmission Customer must either purchase this service from the Transmission Provider or make alternative comparable arrangements to satisfy its Regulation and Frequency Response Service obligation. The amount of and charges for Regulation and Frequency Response Service are set forth below. To the extent the Control Area operator performs this service for the Transmission Provider, charges to the Transmission Customer are to reflect only a pass-through of the costs charged to the Transmission Provider by that Control Area operator.

Schedule 4--Energy Imbalance Service

Energy Imbalance Service is provided when a difference occurs between the scheduled and the actual delivery of energy to a load located within a Control Area over a single hour. The Transmission Provider must offer this

service when the **[30,540]** transmission service is used to serve load within its Control Area. The Transmission Customer must either purchase this service from the Transmission Provider or make alternative comparable arrangements to satisfy its Energy Imbalance Service obligation. To the extent the Control Area operator performs this service for the Transmission Provider, charges to the Transmission Customer are to reflect only a pass-through of the costs charged to the Transmission Provider by that Control Area operator.

The Transmission Provider shall establish a deviation band of +/- 1.5 percent (with a minimum of 2 MW) of the scheduled transaction to be applied hourly to any energy imbalance that occurs as a result of the Transmission Customer's scheduled transaction(s). Parties should attempt to eliminate energy imbalances within the limits of the deviation band within thirty (30) days or within such other reasonable period of time as is generally accepted in the region and consistently adhered to by the Transmission Provider. If an energy imbalance is not corrected within thirty (30) days or a reasonable period of time that is generally accepted in the region and consistently adhered to by the Transmission Provider, the Transmission Customer will compensate the Transmission Provider for such service. Energy imbalances outside the deviation band will be subject to charges to be specified by the Transmission Provider. The charges for Energy Imbalance Service are set forth below.

Schedule 5--Operating Reserve - Spinning Reserve Service

Spinning Reserve Service is needed to serve load immediately in the event of a system contingency. Spinning

Reserve Service may be provided by generating units that are on-line and loaded at less than maximum output. The Transmission Provider must offer this service when the transmission service is used to serve load within its Control Area. The Transmission Customer must either purchase this service from the Transmission Provider or make alternative comparable arrangements to satisfy its Spinning Reserve Service obligation. The amount of and charges for Spinning Reserve Service are set forth below. To the extent the Control Area operator performs this service for the Transmission Provider, charges to the Transmission Customer are to reflect only a pass-through of the costs charged to the Transmission Provider by that Control Area operator.

Schedule 6--Operating Reserve - Supplemental Reserve Service

Supplemental Reserve Service is needed to serve load in the event of a system contingency; however, it is not available immediately to serve load but rather within a short period of time. Supplemental Reserve Service may be provided by generating units that are on-line but unloaded, by quick-start generation or by interruptible load. The Transmission Provider must offer this service when the transmission service is used to serve load within its Control Area. The Transmission Customer must either purchase this service from the Transmission Provider or make alternative comparable arrangements to satisfy its Supplemental Reserve Service obligation. The amount of and charges for Supplemental Reserve Service are set forth below. To the extent the Control Area operator performs this service for the Transmission Provider, charges to the Transmission Customer

are to reflect only a pass-through of the costs charged to the Transmission Provider by that Control Area operator.

Schedule 7 Long-Term Firm and Short-Term Firm Point-To-Point Transmission Service

The Transmission Customer shall compensate the Transmission Provider each month for Reserved Capacity at the sum of the applicable charges set forth below:

1) Yearly delivery: one-twelfth of the demand charge of $---/KW of Reserved Capacity per year.

2) Monthly delivery: $---/KW of Reserved Capacity per month.

3) Weekly delivery: $---/KW of Reserved Capacity per week.

4) Daily delivery: $---/KW of Reserved Capacity per day.

The total demand charge in any week, pursuant to a reservation for Daily delivery, shall not exceed the rate specified in section (3) above times the highest amount in kilowatts of Reserved Capacity in any day during such week.

5) Discounts: Three principal requirements apply to discounts for transmission service as follows (1) any offer of a discount **[30,541]** made by the Transmission Provider must be announced to all Eligible Customers solely by posting on the OASIS, (2) any customer-initiated requests for discounts (including requests for use by one's wholesale merchant or an

affiliate's use) must occur solely by posting on the OASIS, and (3) once a discount is negotiated, details must be immediately posted on the OASIS. For any discount agreed upon for service on a path, from point(s) of receipt to point(s) of delivery, the Transmission Provider must offer the same discounted transmission service rate for the same time period to all Eligible Customers on all unconstrained transmission paths that go to the same point(s) of delivery on the Transmission System.

Schedule 8--Non-Firm Point-To-Point Transmission Service

The Transmission Customer shall compensate the Transmission Provider for Non-Firm Point-To-Point Transmission Service up to the sum of the applicable charges set forth below:

1) Monthly delivery: $---/KW of Reserved Capacity per month.

2) Weekly delivery: $---/KW of Reserved Capacity per week.

3) Daily delivery: $---/KW of Reserved Capacity per day.

The total demand charge in any week, pursuant to a reservation for Daily delivery, shall not exceed the rate specified in section (2) above times the highest amount in kilowatts of Reserved Capacity in any day during such week.

4) Hourly delivery: The basic charge shall be that agreed upon by the Parties at the time this service is reserved and in no event shall exceed $---/MWH. The total demand charge in any day, pursuant to a reservation for Hourly delivery, shall not exceed the rate specified in section (3) above times the highest amount in kilowatts of Reserved Capacity in any hour during such day. In addition, the total demand charge in any week, pursuant to a reservation for Hourly or Daily delivery, shall not exceed the rate specified in section (2) above times the highest amount in kilowatts of Reserved Capacity in any hour during such week.

5) Discounts: Three principal requirements apply to discounts for transmission service as follows (1) any offer of a discount made by the Transmission Provider must be announced to all Eligible Customers solely by posting on the OASIS, (2) any customer-initiated requests for discounts (including requests for use by one's wholesale merchant or an affiliate's use) must occur solely by posting on the OASIS, and (3) once a discount is negotiated, details must be immediately posted on the OASIS. For any discount agreed upon for service on a path, from point(s) of receipt to point(s) of delivery, the Transmission Provider must offer the same discounted transmission service rate for the same time period to all Eligible Customers on all unconstrained transmission paths that go to the same point(s) of delivery on the Transmission System.

Attachment A--Form Of Service Agreement For Firm Point-To-Point Transmission Service

1.0 This Service Agreement, dated as of _____, is entered into, by and between

_____ (the Transmission Provider), and _____ ("Transmission Customer").

2.0 The Transmission Customer has been determined by the Transmission Provider to have a Completed Application for Firm Point-To-Point Transmission Service under the Tariff.

3.0 The Transmission Customer has provided to the Transmission Provider an Application deposit in accordance with the provisions of Section 17.3 of the Tariff.

4.0 Service under this agreement shall commence on the later of (l) the requested service commencement date, or (2) the date on which construction of any Direct Assignment Facilities and/or Network Upgrades are completed, or (3) such other date as it is permitted to become effective by the Commission. Service under this agreement shall terminate on such date as mutually agreed upon by the parties.

5.0 The Transmission Provider agrees to provide and the Transmission Customer agrees to take and pay for Firm Point-To-Point Transmission Service in accordance with the provisions of Part II of the Tariff and this Service Agreement.

6.0 Any notice or request made to or by either Party regarding this Service Agreement shall be made to the representative of the other Party as indicated below.

[30,542]
Transmission Provider:

_____

_____

Transmission Customer:

_____

_____

_____

7.0 The Tariff is incorporated herein and made a part hereof.

IN WITNESS WHEREOF, the Parties have caused this Service Agreement to be executed by their respective authorized officials.

Transmission Provider:

By:
Name _____
Title _____
Date _____

Transmission Customer:

By:
Name _____
Title _____
Date _____

Specifications For Long-Term Firm Point-To-Point Transmission Service

1.0 Term of Transaction: _____
Start Date: _____
Termination Date: _____

2.0 Description of capacity and energy to be transmitted by Transmission Provider including the electric Control Area in which the transaction originates.

_____

3.0 Point(s) of Receipt: _____
Delivering Party: _____

4.0 Point(s) of Delivery: _____
Receiving Party: _____

5.0 Maximum amount of capacity and energy to be transmitted (Reserved Capacity): _____

6.0 Designation of party(ies) subject to reciprocal service obligation: _____

7.0 Name(s) of any Intervening Systems providing transmission service: _____

8.0 Service under this Agreement may be subject to some combination of the charges detailed below. (The appropriate charges for individual transactions will be determined in accordance with the terms and conditions of the Tariff.)

8.1 Transmission Charge: _____

8.2 System Impact and/or Facilities Study Charge(s):

_____

8.3 Direct Assignment Facilities Charge:

_____

_____

8.4 Ancillary Services Charges:

_____

_____

_____

_____

_____

_____

Attachment B--Form Of Service Agreement For Non-Firm Point-To-Point Transmission Service

1.0 This Service Agreement, dated as of _____, is entered into, by and between _____ (the Transmission Provider), and _____ (Transmission Customer).

2.0 The Transmission Customer has been determined by the Transmission Provider to be a Transmission Customer under Part II of the Tariff and has filed a Completed Application for Non-Firm Point-To-Point Transmission Service in accordance with Section 18.2 of the Tariff.

3.0 Service under this Agreement shall be provided by the Transmission Provider upon request by an authorized representative of the Transmission Customer.

4.0 The Transmission Customer agrees to supply information the Transmission Provider deems reasonably

necessary in accordance with Good Utility Practice in order for it to provide the requested service.

5.0 The Transmission Provider agrees to provide and the Transmission Customer agrees to take and pay for Non-Firm Point-To-Point Transmission Service in accordance with the provisions of Part II of the Tariff and this Service Agreement.

[30,543]

6.0 Any notice or request made to or by either Party regarding this Service Agreement shall be made to the representative of the other Party as indicated below.

Transmission Provider:

_____

_____

Transmission Customer:

_____

_____

7.0 The Tariff is incorporated herein and made a part hereof. IN WITNESS WHEREOF, the Parties have caused this Service Agreement to be executed by their respective authorized officials.

Transmission Provider:

By:
Name _____
Title _____
Date _____

Transmission Customer:

By:
Name _____
Title _____
Date _____

Attachment C--Methodology To Assess Available Transmission Capability

To be filed by the Transmission Provider

Attachment D--Methodology for Completing a System Impact Study

To be filed by the Transmission Provider

Attachment E--Index Of Point-To-Point Transmission Service Customers

_____
Customer
Date of Customer Service Agreement

_____

Attachment F--Service Agreement For Network Integration Transmission Service

To be filed by the Transmission Provider

Attachment G--Network Operating Agreement

To be filed by the Transmission Provider

Attachment H--Annual Transmission Revenue Requirement For Network Integration Transmission Service

1. The Annual Transmission Revenue Requirement for purposes of the Network Integration Transmission Service shall be _____ .

2. The amount in (1) shall be effective until amended by the Transmission Provider or modified by the Commission.

Attachment I--Index Of Network Integration Transmission Service Customers

_____

Customer
Date of Customer Service Agreement

_____

In The United States Court of Appeals
For The District of Columbia Circuit

COMPLEX
No. 97-1715

SEPTEMBER TERM, 1997

Transmission Access Policy Study Group, Petitioner	)
v.	)
Federal Energy Regulatory Commission, Respondent	)
Vermont Department of Public Service, Intervenors	)

Consolidated with Nos. 98-1111, 98-1142 and 98-1147

FINAL BRIEF FOR THE PUBLIC SERVICE COMMISSIONS OF NEW YORK, ARKANSAS AND FLORIDA, THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS, THE PUBLIC UTILITY COMMISSIONS OF IDAHO, NORTH CAROLINA, AND WYOMING, THE NEW JERSEY BOARD OF PUBLIC UTILITIES, THE VIRGINIA CORPORATION COMMISSION, THE WASHINGTON

UTILITIES AND TRANSPORTATION COMMISSION, THE VERMONT DEPARTMENT OF PUBLIC SERVICE, THE NATIONAL ASSOCIATION OF UTILITY CONSUMER ADVOCATES AND THE OHIO CONSUMER COUNSEL.

[pp. 1-20]

[1]

I. STATEMENT OF THE ISSUES[2] AND STATUTORY PROVISIONS

1. Did FERC exceed its jurisdiction when it claimed authority to preempt the states' regulation of all unbundled transmission of electricity, including the unbundled intrastate transmission of electricity to retail customers?

[2]

The answer is yes.

2. Did FERC exceed its jurisdiction when it claimed authority to determine the rate treatment of all utility costs initially incurred to provide retail electric service, but subsequently "stranded" as a result of competitive access to utility systems or a municipality's formation of a public electric utility?

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[2]This brief relies on the Petitioners' Joint Statement of the Jurisdiction and the Case for a Statement as to jurisdiction and course of proceedings as well as the statement of facts, as supplemented herein.

The answer is yes.

3. Did FERC exceed its jurisdiction when it claimed exclusive authority over regulation of facilities used in local distribution of electricity to customers who will resell the electricity to end-users?

The answer is yes.

The applicable statutes and regulations are included in a separate addendum.

II. SUPPLEMENTAL STATEMENT OF THE CASE

1. The Transmission/Distribution Distinction

The provision of electric service involves the generation of electricity and then either (i) its transmission and local distribution to the ultimate consumer (retail sale) or (ii) its transmission to a reseller (a wholesale sale), which then transmits and distributes the power to an ultimate consumer (a retail sale). Vertically integrated utilities typically generate electricity at central stations, transmit the electricity over long distances and then distribute electricity to the end-user **[3]** over local distribution lines, typically on radial systems at reduced voltages.

The key distinction between transmission facilities and local distribution facilities is that local distribution facilities normally provide one-way power to serve end-users. Power typically flows into a local distribution facility without re-entering the transmission system, i.e., power does not flow

from a local distribution system to other such systems. A transmission system usually ends at a substation where transformers reduce power voltages to lower levels for local distribution.

The bulk of a utility's system is generation and local distribution plant. Using New York as an example, approximately 15% of electric utility revenues support transmission plant; the remaining revenues support local distribution and generation plant.

2. The Wholesale/Retail Split

Traditionally, electric utilities generated, transmitted, and distributed electricity to their customers by way of their own facilities. These sales are called "bundled" sales because the customer pays a single rate for the commodity and its delivery. As indicated, utilities may also sell electricity at wholesale to another utility, which then resells the power to ultimate consumers on its facilities. Therefore, the same utility facilities are used for both wholesale and retail sales.

[4]

State commissions have traditionally regulated all aspects of bundled retail transactions, including service issues and intrastate sale and distribution of electricity.[3] Traditionally, FERC has regulated wholesale power sales and interstate transmission of electricity, which represent a small percentage of the total use of electric systems.

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[3]The states also regulate the generation of electricity.

3. FERC'S Orders -- Matters Challenged

In the orders under review, FERC has attempted to assert jurisdiction over retail sales, when those sales are unbundled into charges for delivery and electricity. FERC concluded that "open access" gave it jurisdiction over rates for transmission of unbundled electricity for retail sales.[4] Order 888, 1991-1996 FERC Regulations and Preambles (hereinafter Stats. & Regs.) ¶31,036 at 31,980 (J.A. 349).[5] FERC also held that if a wholesale sale of energy makes use of a local distribution system, FERC acquired authority over the local distribution facilities **[5]** used for that sale. FERC Order 888-B, 81 FERC 61, 248 at 62, 098 (J.A. 1074).

Finally, FERC asserted that it has authority over "retail stranded costs," arising from a customer's choice of a new electric supplier, because of its claimed authority over unbundled retail transmission. Recognizing, however, that states had authority over the same retail stranded costs, FERC declined to exercise its purported authority. It concluded that

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[4]FERC thus assumed that it had broader jurisdiction over the wheeling of unbundled electricity than it did over the sale of bundled electricity, and expanded its jurisdiction from 1% of utility revenues (wholesale bulk transmission) to as much as approximately 15% of total utility revenues (i.e., all transmission).

[5]FERC stated that while the states retained jurisdiction over the retail sale of the unbundled power after unbundling, it acquired jurisdiction over the unbundled transmission of that power, formerly part of the bundled retail sale. Order 888, FERC Stats. & Regs. at 31,781-82 (J.A. 150-51); Order 888-A, III FERC Stats. & Regs. ¶ 31,048 at 30,180 (J.A. 663), 30, 339-41 (J.A. 822-24).

unless the state regulatory authority lacked power under state law to address retail stranded costs there was no need for its intervention. Order 888, FERC Stats. & Regs. ¶ 31,036 at 31,825 (J.A. 194); FERC Order 888-A, III FERC Stats. & Regs. at 30,182, 30,417-419 (J.A. 898-900).

FERC further asserted jurisdiction over those utility costs that became stranded by retail customers becoming wholesale customers, for instance, through the formation of municipal electric utilities or the expansion of existing ones.[6] It reasoned such costs would not have been stranded "but for" its decision to order open access to utility transmission facilities. FERC Order 888, FERC Stats. & Regs. at 31, 818-19. FERC Order 888-A, III FERC Stats. & Regs. at 30,404. FERC stated that it would be the primary decision-maker and have the final word on **[6]** recovery of those costs. FERC Order 888-A, III FERC Stats. & Regs. at 40,405.

SUMMARY OF ARGUMENT

Congress enacted the Federal Power Act (FPA Act) in 1935 to close a gap in regulation created by a Supreme Court decision that states could not set rates for wholesale energy sold across state lines. Public Utilities Comm'n of Rhode Island v. Attleboro Steam and Electric Co., 273 U.S. 83, 89 (1927). In closing the "Attleboro Gap," Congress preserved

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[6]An entity that had previously been served by an investor-owned electric utility could decide to municipalize, form its own municipal electric utility, become a wholesale customer, purchase bulk power from the wholesale market, and resell power to its inhabitants. In that case, certain utility costs incurred to serve the area (such as installed generating capacity) could be stranded.

the states' jurisdiction over intrastate retail transmission of electricity. In fact, the FPA expressly shielded state regulation of all retail sales and local distribution systems from FERC jurisdiction. FPA §201(b). In the Energy Policy Act of 1992 (EPAct), Congress reiterated the limitation of FERC's jurisdiction to wholesale transactions.

FERC's assertion of jurisdiction over unbundled retail transactions misreads the FPA's plain language, ignores its legislative history, and misapplies precedent.[7] FERC's attempt to regulate the rate treatment of both retail stranded costs and retail-turned-wholesale stranded costs unlawfully intrudes upon the states' exclusive jurisdiction over retail services and rates.

[7]

Finally, FERC's claim of jurisdiction over wholesale distribution ignores the language and purpose of the FPA, which preserves state authority over the transport of power on local distribution systems.

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[7]The Federal Power Commission (FPC) acknowledged to Congress in 1947 that its jurisdiction did not include "the regulation of rates and service outside of [the Attleboro Gap]." A Bill to Amend Section 201 of the Federal Power Act, Hearings Before Subcommittee on Interstate and Foreign Commerce, 80th Cong., 1st Sess., (hereinafter "1947 Hearings"), at 506 (States' Legislative Appendix "A") . FERC's position today, however, is that the same statutory language the FPC described in 1947 as not preempting state regulation now gives FERC jurisdiction over the transmission of electricity to retail customers.

FERC's position is shown in Attachment A. The States' position is reflected in Attachment B.

POINT I[8]

CONGRESS PRESERVED THE STATES' LONGSTANDING JURISDICTION OVER THE REGULATION OF INTRASTATE RETAIL TRANSMISSION

The Act does not define "transmission" for retail purposes, presumably because customers in 1935 did not pay separate rates for the generation, transmission and distribution of electricity. A full reading of the Act, however, together with its legislative history and the Attleboro case that engendered it, shows that the 1935 Congress preserved the states' longstanding authority over retail intrastate service. Such a reading shows Congress intended that: (1) the regulation of retail transactions be left with the states (1947 Hearings at 547-548) ; and (2) that all solely intrastate transactions be subject to state, not federal, jurisdiction.

[8]

A. In Filling The Attleboro Gap, Congress Did Not Diminish The States' Jurisdiction Over Retail Transactions

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[8]The Arkansas Public Service Commission does not join in this point.

1. Congress Reserved To The States Jurisdiction Over Intrastate Service

Under Section 201(a), 16 U.S.C. § 824(a), FERC may regulate the transmission of electric energy only if the energy is "consumed," or used, in a state other than that in which it was initially transmitted, and if the transmission, is not "subject to regulation by the States."[9] Notwithstanding this statutory constraint, FERC has concluded that "open access" would give it jurisdiction over the transmission of unbundled electricity for retail sales.[10] FERC Order 888, FERC Stats. & Regs. ¶31,036, Appendix G at 31,966 (J.A. 335). FERC's attempt to regulate the transmission of energy for all unbundled retail sales conflicts with the express limitation of FERC's authority. Under the FPA, the states have regulated the transmission of retail energy sales for over 60 years.

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[9]The Act applies to transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce . . . . such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States," 16 U.S.C. §824(a) (emphasis added). "Electric energy shall be held to be transmitted in interstate commerce if transmitted from a state and consumed at any point outside thereof . . ." 16 U.S.C. §824(a) .

[10]FERC has thus assumed that it has broader jurisdiction over the wheeling of unbundled electricity than it had over the sale of bundled electricity, and has expanded its jurisdiction from 1% of utility revenues (wholesale bulk transmission) to as much as approximately 15% of total utility revenues (i.e., all transmission).

[9]

FERC argues that its limited jurisdiction over the transmission of certain electricity encompasses retail transactions because Congress did not expressly limit its jurisdiction to wholesale transmissions. Order 888, FERC Stats. & Regs. ¶31,036, Appendix G at 31,966-67 (J.A. 335-36). Given that "the existence of federal authority to act should appear affirmatively and not rest on inference alone" (Connecticut Light & Power v. Fed. Power Comm'n, 324 U.S. 515, 532 (1945), quoting Yonkers v. U.S., 320 U.S. 685, 692 (1944)), and FERC's inference countermands the Act's safeguarding of state jurisdiction over "local distribution" and facilities used "only for the transmission of electric energy in intrastate commerce," (16 U.S.C. § 824(b)), Order 888 thereby violates the Act's plain language.[11] See Cities of Batavia, Naperville, Rock Falls et al. v. F.E.R.C., 672 F.2d 64, 68, n.2 (D.C. Cir. 1982) [wherein this Court upheld FERC's decision that it lacked jurisdiction over retail rates under 16 U.S.C. section 824j].[12]

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[11]"(1) The provisions of this subchapter shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce, but . . . shall not apply to any other sale of electric energy . . ." 16 U.S.C. section 824(b) (emphasis added).

[12]In 1935, most electric facilities were intrastate facilities (Hearings on H.R. 5423, House Committee on Interstate and Foreign Commerce, 74th Cong., 1st Sess., [hereafter "1935 Hearings"] at 413 and 763). Thus, states' rights advocates in Congress added the "intrastate" clause to the FPA "so that [the Act] specifically will not apply to intrastate business." New York Times,

[10]

2. The Courts and FERC. Itself Have Recognized That Congress' Goal Was To Fill The "Attleboro GAD" Which Had Left Wholesale Transmission Unregulated

The genesis of the Federal Power Act was the Supreme Court decision in Attleboro that state regulation of interstate wholesale sales would burden interstate commerce. 273 U.S. at 89. In the absence of federal regulation, however, that decision meant no regulation of interstate sales whatsoever. Congress filled this "Attleboro Gap" by empowering the FPC to regulate wholesale electricity rates.[13]

June 8, 1935, "Utility Foes Map Floor Fight, 1935 Hearings, Testimony of John E. Benton, General Sollcitor, NARUC, at 748, 763 et seq.

[13]Dozier DeVane, Solicitor of the Federal Power Commission, stated to the House Committee on Interstate and Foreign Commerce that: "... [S]ection 201 is intended to give the Federal Power Commission jurisdiction over the wholesale rates only. (1935 Hearings at 497) ... [T]he plan of this bill with reference to the regulation of rates [is that] it seeks to leave in the state commissions the power to regulate retail rates but through some federal agency assist the state commissions making available to them the proper data for the determination of those rates. Id. at 520. To the same effect, H.R. Report No. 1318, 74th Cong., 1st Sess., at 8, "the [Federal Power] Commission is given no jurisdiction over local rates even where the electric energy moves in interstate commerce" (emphasis added).

But the Act was not a preemption statute; indeed, it preserved state authority in retail matters. The Supreme Court has emphasized that the specific language of FPA section 201(b) expressed Congress' intent to draw a "bright line" easily ascertainable between state and federal jurisdiction:

> What Congress did was to adopt the test developed in the Attleboro line which denied state power to regulate a sale 'at wholesale to local distributing companies' and allowed state regulation of a sale 'at local retail rates to ultimate consumers.' [citation omitted].

[11]

This conclusion has been consistently reaffirmed in subsequent cases. In Panhandle Eastern Pipeline Co. v. Public Service Commission of Ind., 332 U.S. 507, which considered the reach of §l(b) of the Natural Gas Act, the Court said that 'the line of the statute was thus clear and complete. It cut sharply and cleanly between sales for resale and direct sales for consumptive uses. No exceptions were made in either category for particular uses, quantities or otherwise.'

Fed. Power Comm'n v. Southern California Edison, 376 U.S 205, 214, 215 (1964), citations omitted (emphasis added). In the ensuing years, the states have regulated all aspects of electric service to retail customers, as Congress intended.

FERC based its claim here to preempt state regulation of transmission to retail customers on Fed. Power Comm'n v. Florida Power & Light, 404 U.S. 453 (1972), reh'g denied, 405 U.S. 948 and Jersey Central Power & Light v. Federal Power Comm'n, 319 U.S 61(1943). Those cases, however,

were "purely factual" disputes (Florida Power & Light at 463)[14] and uphold FERC's accounting authority over public utilities connected to an interstate grid. Indeed FERC's brief to the Supreme Court expressly disavowed any intention to seek jurisdiction over retail sales. As FERC (FPC) stressed:

> [F]inally, and most important, the Commission's rate jurisdiction over interstate **[12]** sales was limited to sales at wholesale; no authority over retail sales was granted.

FPC Brief on Writ of Certiori to the U.S. Supreme Court, October Term, 1970 at 20, 21 (emphasis added); see FPC v. Southern Cal. Edison, 376 U.S. 205, supra. Thus, FERC cannot now point to Florida Power & Light and Jersey Central as a basis for preempting state jurisdiction over retail transmission.

FERC's position here also conflicts with its longstanding view that the FPA need not be amended to clarify its protection of State authority. In 1947, the FPC stated "in the regulation of rates and service, the definitions [in the Act] have been so drawn to plug and no more the Attleboro gap." 1947 Hearings at 527. And in response to an amendment, proposed in 1967, after the 5th Circuit's decision in Florida Power & Light (discussed supra), the FPC testified that such an amendment was "unwarranted" because "the

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[14]See Carstens, Friends of the Earth, et al. v. N.R.C., 742 F.2d 1546, 1557 (D.C. Cir. 1984) [citing Florida Power & Light for the proposition that when a court considers "a purely factual question within [its] area of competence" the court should defer to the agency.") The issue here is a question of law.

accounting situation (such as the one in Florida Power & Light) differs from rate jurisdiction, where the states regulate retail sales and the FPC regulates wholesales" See 1967 Hearings, Testimony of Hon. Lee C. White, Chairman, Federal Power Commission, at 121, 123, 125.[15]

[13]

3. In 1992 Congress Reiterated That States Would Regulate All Retail Deliveries of Electricity

While expanding FERC's authority to order wholesale wheeling, Congress in 1992 reiterated that FERC could not preempt state regulation of retail wheeling of electricity. 16 U.S.C. §824k. EPAct states: "Nothing in this subsection [giving FERC authority over wholesale wheeling] shall affect any authority of any State or local government under State law concerning the transmission of electric energy directly to an

[15]Notwithstanding its prior assurances to Congress, FERC Order 888 states that "to the extent that retail wheeling involves transmission in interstate commerce by public utilities, the rates, terms and conditions of such service are subject to the exclusive jurisdiction of the Commission" (Order 888, FERC Stats. & Regs. ¶31,036, Appendix G at 31,966 (J.A. 335)).

ultimate consumer" 16 U.S.C. §824k(h) (emphasis added).[16] The legislative history confirms that:

> "the vast majority of the activities of the electric utility industry are subject to state public utility commission jurisdiction, and that has not been changed by this legislation, . . . (Congressional Record, October 8, 1992, at S. 34013). This [act] manifests Congressional intent to continue to limit the FERC's authority to wholesale transactions only, Id. at 34015 (emphasis added) . . . the FERC's authority is strictly limited to transmission services provided for the delivery of bulk power supplies to legitimate wholesale customers" Id. at 34018 (emphasis added).

(emphasis added).

FERC Order 888 misreads EPAct as merely prohibiting FERC from ordering retail wheeling, impliedly assigning FERC jurisdiction over retail wheeling rates. There is no language in **[14]** EPAct that even remotely suggests that although Congress prohibited FERC from ordering retail wheeling, it intended FERC to preempt the states' jurisdiction over retail wheeling rates contrary to FERC's conclusion in

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[16]EPAct should, of course, be read in concert with the 1935 Act. See Imazio Nursery, Inc. v. Greenhouses, 69 F.3d 1560, 1564 (Fed. Cir. 1995) ["It is an elementary rule of construction that all parts of an act relating to the same subject should be considered together . . ."].

Order 888, FERC Stats. & Regs. at 31,781 (J.A. 150). Rather, EPAct gave FERC jurisdiction to order wholesale wheeling on a case-by-case basis, and preserved the states' authority over retail transactions.[17]

4. The Unbundling Of Transmission Rates Does Not Transfer The States' Jurisdiction Over Intrastate Retail Sales To FERC

Nothing in the FPA or its legislative history implies that unbundling a retail sale would exclude the intrastate transportation component of that sale from state jurisdiction, leaving the states with control over only the commodity. The underlying transaction remains an intrastate transmission of energy to retail customers, which is the part of the transaction directly affecting customers that Congress left with the states. 16 U.S.C. §824(b)-(c) . See Arkansas Elec. Coop. Corp. v. Arkansas Public Service Comm'n, 461 U.S. 375, 394 (1983)

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[17]FERC stated that its primary purpose for issuing FERC Order 888 and its progeny is "to remedy undue discrimination in the provision of interstate transmission services by public utilities." FERC Order 888-A, III FERC Stats. & Regs. at 30,175 (J.A. 658) . It presents no evidence, however, that discrimination has taken place, and it has not even attempted to show why state commissions are incapable of preventing such discrimination at the retail level. See Congressional Record, October 8, 1992, Discussion of Senator Wallop (R-Wy), at S. 34014. FERC can address alleged discriminatory denial of transmission access in wholesale sales or in wholesale transmission rates sales. FERC's dramatic seizure of power over unbundled retail transmission, however, is not supported by any Congressional goal of preventing discrimination.

[15] [["a]lthough AECC is tied into an interstate grid, its basic operation consists of supplying power from generating facilities located within the State to member cooperatives, all of which are located within the State"].

FERC's reading of the EPAct, if adopted, would also impede Congress' goal of encouraging competition in the electricity market. See Energy Policy Act of 1992, Pub. L. No. 102-486, 1992 U.S.C.C.A.N (102 Stat.) 1961-1962. Under FERC's theory, states that advanced Congress' will by unbundling retail tariffs would suffer diminished jurisdiction, while states that did not unbundle, and thereby impeded competition, would avoid preemption.[18]

United Distribution Companies v. Federal Energy Regulatory Comm'n, 88 F.3d 1105, 1153 (1996), cert. denied, 117 S. Ct. 1723 (1997), cited by FERC to support its contrary claim (FERC Order 888-A, III FERC Stats. & Regs.

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[18]FERC's decision on retail transmission gives rise to a variety of transmission arrangements. For instance, (1) an end-user could choose bundled service, which FERC agrees is fully subject to state regulation; or (2) an end-user could purchase electricity from a "reseller" of energy that is the wholesale customer for the unbundled transmission service; finally, (3) an end-user could piece together its own package of services by purchasing unbundled transmission service from a utility and purchasing energy from a wholesaler, either from out-of-state (3a), where it would be an unbundled retail transmission in interstate commerce, or in-state (3b) when it would be an unbundled retail transmission in intrastate commerce.

at 30,336 (J.A. 819), does not do so. Among other distinctions, United Distribution addressed only interstate gas transportation. 88 F.3d at 1153. ["FERC retains jurisdiction over the interstate transmission component of a retail sale" (emphasis added)]. Indeed, this Court **[16]** distinguished its holding giving FERC jurisdiction over interstate transportation from those "interstate pipelines that receive natural gas at their state boundary that is consumed within the state and subject to state commission regulation." United Distribution, 88 F.3d at 1153, n.62.

5. FERC's Jurisdictional Arguments Do Not Warrant Deference

Because Congress has spoken directly to the matter at issue, FERC's construction of its statute is entitled to no special deference:

> If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency must give effect to the unambiguously expressed intent of Congress. Chevron U.S.A.v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43 (1984).

In sections 201(a), 201(b) and 212(h) of the Federal Power Act, Congress preserved state power over retail sales. Moreover, defining retail jurisdiction does not require application of FERC's technical expertise (Compare, Elec. Indus. Ass'n Consumer Elecs. Group v. FCC, 636 F.2d 689, 695 (D.C. Cir. 1980)); nor do the general provisions of the FPA delegate to FERC oversight over the complexities of the

entire electric industry (Compare, Dept of Health and Human Services v. Fed. Labor Relations Auth., 976 F.2d 1049 (D.C. Cir. 1992)).

Even if Congressional intent were unclear, FERC's construction would not deserve deference because, where a federal agency attempts to preempt areas traditionally regulated by the **[17]** states, the Court "start[s] with the assumption that the historic police powers of the States were not to be superseded unless that was the clear and manifest purpose of Congress." Hillsborough County v. Automated Medical Laboratories, Inc., 105 S. Ct. 2371, 2376 (1985).

Further, FERC's assertion of jurisdiction over retail transmission is unsupported by statutory language or history, which abound in contrary statements. Chevron U.S.A.v. Natural Resources Defense Council, Inc., 467 U.S. 843 (1984); Southeastern Michigan Gas Co. v. FERC, 133 F.3d 34, 43 (D.C. Cir. 1998). The FPC itself stated that: "The important task of the regulation of consumers' rates is left entirely to the States. 1935 Hearings, Testimony of FPC Commissioner Clyde Seavey at 384 (emphasis added); see New York Times, March 8, 1935, "Rayburn Bill Held No Blow To States". Although Congress, in 1935, could not contemplate a competitive, unbundled market, it clearly relied on the FPA's precise assignment of state jurisdiction, which "carefully preserved the States' essential regulatory authority over matters of local import," and did "not assign to the Commission any authority over retail rates." 1967 Hearings at 124 (emphasis added).

B. FERC Regulation of Intrastate Retail Transmission Would Be Unwieldy And Detrimental To Electric Customers

1. FERC Regulation Would Be Infeasible

Ratemaking entails a delicate balancing of interests (e.g., Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989)), particularly with respect to retail rate regulation, which **[18]** involves numerous, diverse customers. When asked in 1947 whether the federal government was better equipped than the states to regulate retail rates and services the FPC's Assistant General Counsel stated, "I definitely say, No" (1947 Hearings at 575). single federal agency simply cannot balance ratepayer and shareholder interests for hundreds of companies nationwide.

2. The States Are Better Equipped To Regulate Customer Service

The development and enforcement of retail service standards also requires sensitivity to local conditions that only state commissions can provide. Overly stringent standards can drive up costs and deter economic growth, while insufficient safeguards can endanger customers' safety and welfare.[19]

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[19]For example, FERC has made it clear that it does not intend to apply gross negligence standards commonly applied by states in assessing a utility's liability for service failures. American Elec. Power Serv. Corp, et al, 78 F.E.R.C. ¶61,070 at n. 28 (1997); New York State Elec. & Gas Corp., 79 F.E.R.C. ¶61,371

Under FERC's approach, it would be required to handle retail customer complaints about transmission service from all over the country. The States are in a far superior position to handle customer service problems and protect the rights of small retail consumers.

Beyond that, the advent of retail access enables millions of retail electric customers to contract with alternative **[19]** providers of transmission service. Inevitably, these customers will encounter service, billing and other difficulties. State organizations that have long dealt with similar problems will be able to deal with those issues when they arise in an unbundled environment. FERC lacks any capability to handle complaints of retail customers, yet its approach would require it to do just that.

3. FERC Preemption Could Undermine The Reliability Of Electric Service

Reliability standards for electric service, and the costs that should be incurred to meet them, must be addressed on a local level based on local system conditions. These issues defy a one-size-fits-all analysis.

(1997), 1997 FERC Lexis 1244 at 16, n.15. These state "gross negligence" standards have been upheld by state courts (see, e.g., Food Pageant v. Consolidated Edison Co., 54 N.Y.2d 167, 172 (1981); San Dieqo Gas & Elec. Co. v. Superior Ct. of Orange County, 13 Cal. 4th 893, 917 (1996); Garrison v. Pacific Northwestern, 45 Ore. App. 523, 526 (1980)). Holding utilities to an ordinary negligence standard could raise their costs dramatically, a trade-off best assessed by state agencies.

Additionally, FERC's open access provisions conflict with state provisions for energy balancing, dispute resolution, customer security deposit requirements, consumer complaints, and credit worthiness requirements for receiving service. See, Consolidated Edison Co. of N.Y., Open Access Transmission Tariff, Docket No. ER98-1631-000 and ER 98-270-000 [wherein Con Edison has requested waivers from FERC for such requirements]. While FERC has deferred to the states on some of these issues, it nonetheless claims the last word on various intrastate matters reserved by Congress to the states. Additionally, FERC's Open Access provisions cannot realistically be applied to retail service, so utilities and state commissions have been forced to seek FERC waivers on a variety of issues pertaining to retail access.

[20]

The states have more of the information needed to determine the level of reliability required to maintain customer satisfaction and economic health and to respond to system emergencies. It is not feasible for a federal agency to become familiar with the intricacies of local system design and the needs of the many disparate areas within each of the contiguous 48 states. The tendency to develop a one-size-fits-all approach based solely on national goals could be ruinous to local service reliability.

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[30]

B. -FERC's Theory For Preempting State Jurisdiction Over Local Distribution Facilities Is Baseless

1. FERC's Theory Conflicts With Its Identification Of Facilities As Local Distribution

FERC created a jurisdictional test consisting of seven indicators to be applied in determining whether a facility is "local distribution," and hence beyond its jurisdiction.[33] If FERC's criteria establish that a facility is a local distribution facility, then the facility and the transport of energy on it are exempt from FERC's jurisdiction as a matter of law, even though the transactions occurring on it are wholesale transactions.

Case law (as FERC itself recognized in Order 888)[34] exempts local distribution facilities from federal jurisdiction and requires that before FERC can assert jurisdiction over such facilities, it must first make a factual determination that they are not local distribution facilities.

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[33]FERC Order 888, FERC Stats. & Regs. at 31,770-71 (J.A. 139-40), 31,780-83 (J.A. 149-52) .

[34]FERC Order 888, FERC Stats. & Regs. at 31,783, n. 546 (J.A. 152).

> Whether facilities are used in local distribution -- although a limitation on FPC jurisdiction and a legal standard that must be given effect in addition to the technological transmission test (citation omitted) -involves a question of fact to be decided by the FPC as an original matter. Federal Power **[31]** Commission v. Southern California Edison Co., 376 U.S. 205, at 210, n.6 (1964).

This holding, by which FERC itself was "particularly persuaded,"[35] makes no distinction between bundled and unbundled sales. The seven-indicator test established in FERC Order 888[36] represents FERC's current judgment as to what constitutes local distribution, and should be applied in all instances to define the local distribution facilities subject to state regulation rather than federal.[37]

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[35]Order 888, FERC Stats. & Regs. at 31,783 (J.A. 152), n. 546.

[36]FERC Order 888, FERC Stats. & Regs. at 31,770-71 (J.A. 139-40), 31,780-83 (J.A. 149-52).

[37]In Connecticut Power & Light v. Federal Power Comm'n, 324 U.S. 515 (1945), the Court first expressed the need to limit the corresponding potential reach of federal jurisdiction and then discussed the need for enforcing the local distribution facilities exemption in order to reconcile the claims of federal and local governments.

In Arkansas Power & Light v. Federal Power Comm'n, 368 F.2d 376 (8th Cir. 1966), the Commission argued that

FERC ignores its own factual determination when it claims jurisdiction over any facility transporting energy for **[32]** resale.[38] It apparently reasoned that, because wholesale sales of energy, by definition, do not occur on local distribution facilities, such sales must therefore transform a facility that would otherwise be "local distribution" into a FERC-jurisdictional facility. This reasoning is illogical, however; clearly, the function of a facility does not depend on whether a wholesaler decides that title to energy will pass to

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inasmuch as there were wholesale sales for resale, the nature of the lines was irrelevant. The Court noted that, although the Commission stated that evidence concerning the nature of the lines was not relevant, it had made a factual finding as to local distribution and thereby complied with Federal Power Comm'n v. Southern California Edison Co., 376 U.S. 205, at 210 n. 6, infra.

[38]FERC cites Wisconsin-Michigan Power Co. v. Federal Power Comm'n, 197 F.2d 472 (7th Cir. 1952), in its discussion of jurisdiction over wholesale distribution. Order 888, FERC Stats. & Regs. ¶31,036, Appendix G at 31,914 (J.A. 283). That case, however, stands for the proposition that FERC lacks jurisdiction over facilities that it finds to be "local distribution." The Court determined that sales to wholesalers for resale were not made over facilities used in local distribution because the facilities employed were not located at points on the system where local distribution starts and is carried. The court noted that jurisdiction over local distribution of electric energy is reserved to the states and the authority of the states to fix local rates is not disturbed, even in those cases where the energy is brought in from another state. 197 F.2d at 476.

a reseller at a retail customer's meter or path at some upstream point, such as a utility substation.

FERC offers no reasoned analysis of why local distribution should be defined differently for wholesale sales and retail sales; its decision to attempt such a differentiation without such analysis and explanation should be rejected as arbitrary. Transactive Corp. v. United States, 91 F.3d 232 (D.C. Cir. 1996).

EPRI PRIMER ON ELECTRIC POWER FLOW FOR ECONOMISTS AND UTILITY PLANNERS

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[p. 1]

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A Primer on Electric Power Flow for Economists and Utility Planners

Prepared by
Incentives Research Inc.
Boston, Massachusetts

* * * * *

[2-6]
Resistance and Ohm's Law

Since power is dissipated in a circuit, some force that is opposed to the flow of current must be at work. The example of a locomotive is analogous in some respects. In a frictionless, gravitation-free world, once the initial inertia had been overcome and the locomotive had been given momentum, the locomotive would continue indefinitely its motion at a constant speed without further work being required. But in the real world, power must be applied continually to compensate for frictional forces opposing the direction of motion in order to maintain the locomotive's speed.

A similar problem arises within a conductor. The electrical analogue to file coefficient of friction is *resistance* (symbol *R)*. The resistance of a conductor is a measure of its opposition to current flow; it is a physical property that varies with the conductor's shape, temperature, and other factors. The unit of resistance is the *ohm* (usually signified by the upper case Greek letter omega, Ω).[8] Certain resistance in a conductor can be understood by regarding resistance as being file result of electron-atom "collisions" within the conductor.[9]

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[8]Named for German physicist George Simon Ohm (1787-1854).

[9]Technically, the electrons and conductor atoms do not collide like billard balls, but the movement of the electrons is deflected in a fashion similar to collisions by the electrical fields

When current flow is increased, more collisions occur and more power is dissipated. The resistance of a copper wire is halved when its cross-sectional area is doubled because fewer electron-atom collisions will occur in a thicker wire. A wire with twice the length will also have twice as many collisions and therefore twice the resistance.

> A good conductor allows electrons to flow easily, but they do not necessarily flow fast. The average electron drift velocity is equal to the current per cross-sectional area of a wire divided by the electron density. Algebraically: $v = i/(Ad)$. Applying this formula we discover, perhaps **[2-7]** surprisingly, that the speed of electrons in a current-carrying conductor is very low. In copper there are roughly 1.38×1024 free electrons per cubic inch; a #14 AWG copper wire (which is about 1/16 inch in diameter) has a cross-sectional area of 3.23×10^{3} square inches. For a current of ten Amperes the electron drift velocity is only v = 0.000356 meters per second, or 1.28 meters per hour![10] Of course, an immense nmnber of electrons is moving at this lethargic pace. Moreover, the electric impulses (voltage propagation) associated with these electron movements travel at nearly the speed of light,

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surrounding the electrons of the conductor atoms.

[10] 1.28 m/h = [10C/s]·[1/3.238x10^{-3} in^2]·[1in^{3}1.38x10^{24}electrons]·[0.254m/inch]·[1 electron/1.602x10^{-19}C]

$c = 2.978 \times 10^8$ meters per second. Each electron's movement induces a sequence of movements in other electrons downstream in the wire, with the result being current (or power) that propagates at an enormous speed.

Good conductors have small values for R. A measure of the lack of opposition to current in a conductor, *conductance,* is the reciprocal of the resistance of the conductor: $G = 1/R$. The SI unit of conductance (G) is the *siemens* (S) or the mho.[11]

A *resistor* is a circuit element flint has a known resistance. Electronic circuits often include numerous resistors of different sizes. Their combined effect can be determined using the following rules of combination for resistors:

[Diagram omitted]

The effective resistance of n resistors in *series* (placed sequentially in a single path) is the sum of their individual resistances:

$$R_{total} = R_1 + R_2 + \ldots + R_n.$$

[Diagram omitted]

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[11]The siemens is named for British engineer Sir William Siemens (1823-1883).

The effective conductance of *n* resistors in *parallel* (placed side by side, creating alternative paths) is the sum of their individual conductances:

$$G_{total} = G_1 + G_2 + \ldots + G_n,$$

or equivalently,

$$1/R_{total} = 1/R_1 + 1/R_2 + \ldots +$$

Note that this R_{total} will be smaller than any of the individual parallel resistances.

Individual conductors have a fairly constant resistance under normal operating conditions.[12]

[Diagram omitted]

[2-8]

Ohm's Law states that the current through a conductor is directly proportional to the applied voltage, where the proportionality constant is the conductance of that conductor: $I = EG = E/R$. One ohm is defined as the resistance that permits a current of one ampere to flow when a potential difference of one volt is applied across the resistance: $1\Omega = (1\ V)/1\ \Lambda$. One way to think of resistance, current, and voltage is to compare a resistor to a hole in a leaky balloon. The air

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[12]For the purposes of this chapter, conductors will be treated as idealized, having no resistance, while circuit elements will be treated as having a constant *R* that does not vary with conditions of use. In practice, temperature can affect the resistance of both conductors and electronic components.

in a balloon will escape faster (increased current) if the hole is widened (reduced resistance). Another way to increase the rate of escape is to increase the pressure differential (increased voltage) between the gas inside the balloon and the gas outside the balloon.

As stated previously, voltage is the ratio of power to current ($E = P/I$). Multiplying both sides of this equation by I yields $P = EI$, so the power dissipated by a circuit is the product of the voltage and the current. Substituting $I = E/R$ from Ohm's Law into the power equation shows that $P = E \cdot (E/R) = E^2/R$. Alternatively, substitution of Ohm's Law in the form $E = IR$ yields $P = IR \cdot I = I^2R$. Thus for a circuit with resistance R, power dissipation increases as the square of voltage or current, e.g. doubling file applied voltage doubles the current but quadruples the power dissipation.

The above rules on combining resistances imply that if a voltage is applied to resistors in series, the current through each of the resistors will be the same, $I = E/R_{total}$. If the resistors are in parallel, each resistor of a different size will have its own corresponding current, but the total current will be $I_{total} = E \cdot G_{total}$.

Kirchhoff's Laws

Almost any interesting circuit consists of several paths serving several kinds of devices. Kirchoff's Laws define physical constraints governing how power or current will flow in any network with several paths:

- *Kirchhoff's Current Law* (KCL) states that the sum of the currents entering a point in an electric circuit must

equal the sum of the currents leaving that point. Equivalently, the net current into and out of any point must be zero.

[2-9]

- *Kirchhoff's Voltage Law* (KVL) states that in any closed electric circuit, the sum of the voltage drops across the circuit elements must equal the sum of the applied emf's around every closed loop.

With the use of these laws, the flows on a simple circuit can be predicted. The circuit at right [diagram omitted] includes a direct voltage source (12 V battery), a resistive load (a lamp rated 3 W at 12 V), a switch, and a few conductors (wires) linking these components in series. The resistance of the wires and internal resistance of the battery can be ignored since they are very small compared to the resistance of the lamp.

When the switch is open, there is no path through which the current may flow. Closing the switch creates a path. KVL states that the net voltage around the closed loop must be zero. Since the battery is providing 12 volts, the *voltage drop* across the resistor must also be 12 volts. That is, the potential difference between points A and B is 12 V, but between B and C it is zero. The amount of current that flows can be determined with the voltage-defining equation E = P/I. The lamp draws 3 W at 12 V, so the current flow

$$I = P/E = (3\text{W})/(12\text{ V}) = 0.25\text{ A}.$$

The lamp is a special kind of resistor, the resistance of which can be deduced from Ohm's Law:

$$R = E/I = (12\ \text{V})/(0.25\ \text{A}) = 48\Omega.$$

Adding another 48Ω lamp in series to the existing circuit elements will alter the circuit in several respects. The direct voltage source still provides 12 V, but the total resistance is doubled, to 96 Ω, since series resistance is additive. The entire supply current flows through both of the resistors (lamps) but is now smaller:

[Diagram omitted]

$$I = E/R_{total} = (12\ \text{V})/(96\ \Omega) = 0.125\ \text{A}.$$

The voltage (drop) across the original lamp is now half as large:

$$E = IR = (0.125\ \text{A})(48\ \Omega) = 6\ \text{V}.$$

[2-10]

We could have used Kirchoff's Laws to establish these results: By KVL, the voltage drop across the two lamps must add up to 12 volts. Since the two have the same resistance value, the voltage drop across each must be the same, i.e. 6 volts. By KCL, the current flowing in the loop must be the same as the current flying across each resistor:

$$I = E/R = (6\ \text{V})/(48\ \Omega) = 0.125\ \text{A}$$

Total power dissipated with two lamps in series is:

$$P = EI = (12\ \text{V})(0.125\ \text{A}) = 1.5\ \text{W},$$

versus 3 W with only one lamp. Thus less light is enjoyed than would have been produced by one lamp alone.

[Diagram omitted]

Placing the second 48 Ω lamp in parallel instead of in series produces a different result. Total conductance is additive for parallel resistors, so

$$\begin{aligned} G_{total} &= 1/(1/R_1 + 1/R_2) \\ &= 1/(1/48 + 1/48) = 1/24 \text{ siemens} \end{aligned}$$

The effective resistance of the two lamps in combination is therefore

$$R_{total} = 1/G_{total} = 24\ \Omega,$$

one-half of the resistance of either lamp by itself. By KVL, the voltage across each lamp is the same and equal to the source emf, 12 V, so the current through the original lamp is

$$I_1 = E \bullet G_1 = 12\ \text{V})/(48\ \Omega) = 0.25\text{A}.$$

Since G_2 is the same as G_1, I_2 also equal 0.25 A. By KCL the total current supplied by the battery is:

$$I = I_1 + I_2 = 0.25\ \text{A} + 0.25\ \text{A} = 0.5\ \text{A}.$$

Total power dissipation in the form of light is now $P = EI =$ (12 V)(0.5 A) = 6 W, twice as much as with one lamp alone (so now our battery will not last as long).

Thus we see that the number and location of circuit elements has a critical effect on the currents, voltages, and power dissipation in the circuit. In this example, adding the second lamp will either halve or double the total power dissipation in the circuit, depending on whether the new lamp is installed in series or parallel. Accordingly, for any planned circuit, the designer must anticipate that both of Kirchoff's Laws will hold when choosing the location of circuit elements.

KCL is true because electrons are never destroyed or created at any point in the circuit. KVL is a consequence of the fact that current always flows through a circuit in a fashion **[2-11]** that minimizes power consumption (I^2R losses). To demonstrate this connection to minimal power losses, consider the following circuit:

Power dissipation $P = I_1^2R_1 + I_2^2R_2$

$= I^2R_1 + (I - I_1)^2 R_2$

$= I_1^2R_1 + I^2R_2 - 2II_1R_2 + I_1^2R_2$

P is now a function of I having a minimum where

$$dP/dI = 2IR_1 - 2IR_2 + 2I_1R_2 = 0$$

$$IR_1 = (I - I_1)R_2 = I_2R_2$$

which is KVL for the closed loop ABCD.

[Diagram omitted]

* * * * *

[3-1]

Chapter 3

Structure of Utility Systems

In the previous chapter, the behavior of electricity in a variety of devices was explored. A number of rules were introduced, chiefly in the form of equations, to make possible the analysis of any circuit. In this chapter, some of the ways in which electric utility networks differ from the simple networks of the previous chapter are explained.

- Electric utilities produce power in generators that rotate electric magnets within a frame housing three equally spaced conducting coils, resulting in three distinct "phases" of electricity that differ in timing from each other by 120°. This "3-phase generation" results in considerable capital and operating economies in transmitting power by reducing the number of conductors and the power losses in each. The algebra for determining the combined effects of the three phases depends on whether they are connected in an arrangement that resembles either the letter Y or a triangle, called a "wye" or "delta" arrangement respectively.

- Numerous transformers are used throughout a utility system to increase voltages for efficient transmission and to decrease them to safe and practical levels for distribution subsystems and end-use devices. For transmission planning and control purposes a local

distribution subsystem can be modeled as a single lumped impedance in parallel with the transmission system.

- Transmission lines have their own impedances that must be taken into account by system planners. In particular, the conductors of a transmission line are inherently inductive especially when heavily loaded, which causes them to absorb reactive power. Reactive power must be supplied to the network in order to offset the inductance of the lines and of certain end-use loads such as industrial motors. This can be produced by generators and transmitted but it is of'ten more economically provided at the site of the reactive load.

  Such reactive power "compensation" is desirable because it reduces the amount of current required to deliver a given mount of real power, and it improves voltage control. It is provided by reactive elements added in parallel (shunt) or series to the transmission lines. A shunt capacitor supplies reactive power while a series inductor **[3-2]** consumes it. Compensation can be either passive (fixed) or active (variable in response to system conditions).

- When power demand changes or system resources are lost due to unplanned disturbances, generator output levels must be adjusted almost instantaneously to keep from over- or under-loading circuits. Conservation of energy dictates that an increase in the electric energy delivered to the loads will cause the kinetic energy (frequency) of the generator turbines to decrease.

Changes in the system frequency as well as in tie-line flows for contractual power exchanges with other utilities can be monitored and used to trigger adjustments to the steam injection into the turbines as needed to restore equilibrium and economical operations. For small changes in load, such adjustments occur in real time under the control of electronic telemetry and feedback mechanisms called Automatic Generation Control. Large changes in load or system status must be anticipated and handled with human intervention.

- Several terms and measurements are used to describe a utility system's ability to accommodate changes in power demand or supply availability. "Reliability" is measured by the probability of loss of service to consumers due to unplanned disturbances to system resources, especially unplanned outages of generating units. Reliability is improved by having redundant generation and transmission capacity and by interconnection with other, adjacent utilities. "Security" refers to the ability of the system to accommodate redirected power flows resulting from a sudden loss (e.g. due to lightning) of the transmission circuit between pairs of buses. "Stability" concerns whether generators will remain in synchronization with each other as they jointly respond to changes in system status. Operating transmission and generation resources below their theoretical capacity limits generally improves security and stability.

* * * * *

[3-12]
Transmission and Distribution

Figure 3.1 on the next page is a schematic representation of how generation, transmission and distribution resources are configured in a utility system. At the source of electric power, different kinds of energy (kinetic, chemical, nuclear) are converted into electric energy in a three-phase generator producing power at around 15,000 volts. Transformers then step up this voltage to a few hundred thousand volts at a *bus* to the transmission line. A bus is any location where electrical devices have interconnected inputs and outputs. There are buses at the junctions of transmission lines with generators, transformers, other transmission lines and distribution subsystems.

Three-phase transmission lines carry low current, high voltage power through isolated areas, using three or four cables (depending on whether the neutral line is present or not). Typically, voltages of 69,000 Volts or above are deemed transmission level, while conductors operating at or below 13,000 Volts are usually accounted for as part of the distribution system. Near the distribution areas a step-down transformer (substation) decreases the voltage and adds the neutral line that is used in the provision of the single-phase power to consumers. Different types of loads use a different number of phases to **[3-13]** meet their power and voltage needs. Three-phase motors take advantage of the constant instantaneous three-phase power, while resistive devices like stoves and light bulbs use line or phase voltage, according to the size of their requirements.

[Diagram omitted]

The transmission system is electrically isolated from the structure and performance of the distribution systems by step-down substation transformers. For transmission planning purposes this means that regional distribution-level loads can be aggregated and regarded as the effects of a single impedance. Operationally, this electrical isolation makes each distribution region relatively immune to the effects of disturbances in other regions, e.g. when lightning knocks out a distribution line. Changes in the end-use load requirements are conveyed back to the transmission system by the substation transformer through changes in current. An increase in power demand at the customer loads causes an increase in the distribution level current flint induces a corresponding change in the current level on the transmission side of the transformer. These current variations will cause the generators to deliver more or less power as needed, through feedback mechanisms explained below.

Not shown in Figure 3.1 are the important components for transmission system monitoring and protection, such as circuit breakers, capacitor banks, and the system operating center. In addition, this figure depicts only a single path from one generator to the load(s). Any real utility includes several generators interconnected to loads in more of a web-like geometry, with multiple paths on which the power will flow. By virtue of Kirchoff's Laws, power arriving at any bus will distribute itself in part to each of the other circuit paths going out of that bus, in inverse proportion to their respective impedances. This phenomenon is referred to as *loop flow;* it has the consequence that power cannot be directed to flow along specific circuits, e.g. just those owned by a particular

utility or those that happen to be operating at below their rated capacity. Loop flows can become a financial and operating problem when power spreads out over lines not owned by the parties scheduling a power transfer.

Control of Generators

It is critical that generation facilities be able to respond essentially instantaneously to the shifting patterns of electric load and that the transmission system have enough flow capacity and controllable voltage support (reactive power compensation) to serve a wide **[3-14]** range of demand requirements. Much of this control must be automatic, relying on feedback from the system itself to guide the corrective actions. Two indicators of system status are primarily relied upon for much of this *Automatic Generation Control (AGC):* system frequency and tie-line flows.[8]

Contract terms and regulatory requirements, and practical engineering considerations require a utility to provide electric power within a very narrow range of frequencies. Even modest deviation can cause severe damage to generators and to electric equipment designed specifically for 60 cycles per second. Steam turbines in particular are vulnerable to fatigue and cracking if operated away from 60 Hz by as little as $\pm$ 0.05 Hz for even a few minutes. A fully loaded steam turbine may be able to sustain 58 Hz for no

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[8]Voltages are also closely monitored in order to protect system stability, but frequency and tie-line changes are the primary barometers for maintaining the economic operation of the system. See Chapter 5 for a fuller discussion of stability.

more than ten minutes cumulatively over its entire operating life.[9]

When the mechanical torque on the turbines (due to the steam or other prime mover) is exactly equal to the opposing electrical torque (arising from the counter-emf in the loops of the generator), the frequency of rotation will be a constant. However, when the power demand changes so that it no longer equals power supplied, the rate of rotation of the generator(s) will automatically increase or decrease as dictated by conservation of energy. For instance, when the load increases, the electrical torque exceeds the mechanical torque, causing the frequency of rotation (hence of the supplied alternating current) throughout the system to decline. More prime mover energy (water flow, steam, etc.) must be supplied to one or more generators to balance the increased power demand. A mechanism on each load-following generator called the *governor* manages these changes in energy input whenever the frequency change exceeds a narrow "deadband" range. A gas-fired peaking plant will have a narrower deadband and a faster response than a baseload coal plant, so the peaking plant will respond first to any short-term variations in load. By adjusting the responsiveness of these generators (called the *droop),* the desired sharing of responsibility across several generators for load changes can be pre-programmed into the system. As will be explained

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[9]To protect the system and its customers, load shedding is scheduled to occur in the MAIN NERC region in 10% blocks, whenever frequency drops to 59.3, 59.0, and 58.7Hz. See Stambach and Ewart, EPRI EL-6360-L, 1989 for a discussion of frequency tolerances and for operating procedures to manage transmission system dynamics.

further below, this adjustment actually involves two phases. **[3-15]** First the plants' mechanical power is matched to the electrical power demanded, usually in a matter of two to ten seconds. This will not occur at 60 Hz but, at a slightly lower frequency when meeting increased demand. Second, the governor *setpoints* are gradually adjusted over a few minutes to move the system back to 60 Hz. Within certain limits, these adjustments can be done in a fashion that achieves an economic dispatch order among the participating plants.

One very important concern for transmission planners and system operators is maintaining system *stability* at or very near 60 Hz as multiple generators adjust to accommodate a new demand or supply condition. The governor mechanisms cannot usually cause an immediate, direct restoration of the system frequency. Instead, the momentum built up in the turbines when they initially respond to increased loading causes them to overshoot the 60 Hz target a bit. Provided they do not overshoot by too much, the electric torque will act as a brake on the generators and induce a reverse correction. Ideally, these oscillations quickly dampen out and converge on 60 Hz for all generators on the system. If they do not, and the generators fall out of synchronization with each other, voltage variations throughout the system can become erratic and extreme, creating unintended power flows that trigger rapid protective shutdown of overloaded circuits. Again by conservation of energy, this sends very strong feedback signals to the generators, occasionally creating a very

complex problem that results in widespread *voltage collapse*.[10] Thus it is critical that system frequency be tightly controlled.

Most utilities are interconnected with several of their neighboring utilities. This linkage affords considerable capital and operating economies, largely because of economies of scope and the related benefits of risk diversification. With a larger network, more alternative paths are available for moving power to each demand node. With more generators interconnected, the probability of unplanned plant outages flint comprise a significant portion of total load is greatly reduced, so generation capacity reserve margins **[3-16]** per MW of peak load can be lower for a given target level of *reliability*. (Reliability is often measured by the probability that plant outages will make it infeasible to serve the entire power demand. Utilities usually maintain sufficient generation and transmission capacity reserves that this is a very unlikely possibility). The total load of an interconnected system itself is somewhat more stable than that of an individual utility because of imperfect correlation of demand across the large

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[10]While protracted metropolitan blackouts due to voltage collapse are fairly rare, collapses lasting a few seconds to a minute have occurred roughly once annually throughout the developed world every year since 1970. Most recently (12/14/94), an outage at a 345 kV substation i Idaho (and possibly other events) triggered a cascading outage that affected ten states and British Columbia, causing the WSCC interconnected system to separate into four islands. The power was restored in most areas within a few minutes, though some were out for a few hours. See NERC, August 1991, for a survey of the causes of and planning procedures for coping with this risk, and Electric Utility Week (12/19/94) for details on the WSCC event.

pool of end-users. This allows better utilization of baseload plants to capture their operating economies of scale. All of these pooling benefits improve system reliability and decrease capital and operating costs. In order to manage how such benefits are shared, the interconnected utilities must control the *tie-lineflows* between themselves at their borders. Tie-line flow measurement and management are the second important means of achieving economic performance goals for the transmission and generation system.

Operationally, interconnected or "pooled" utilities are usually managed as several *control areas,* within each of which there is a sufficient number of generators to follow load and to control system frequency and tie-line exchanges. The fie-lines between control areas are used for contractual power flows under pooled dispatch (economy interchange), wheeling arrangements, bulk power sales from one utility to another, and unplanned flows that occur when one utility suddenly needs the slack generation capacity of another for rectifying an emergency condition. Any change from scheduled tie-line flows becomes the basis for centrally controlled (pool level) corrective action (primarily to the generators) in order to assure that one utility does not inadvertently supply replacement power to another without compensation. The adjustments to restore planned fie-line flows are not necessarily the same as those that would restore the system frequency. Such changes in flows or system frequency are called *area control errors* (ACE). The ACE is measured every few seconds at each control area. It is given by:

$$ACE_j = \text{average frequency in control area}_j \bullet \text{bias}_j + \text{net unscheduled tieline flows into or out of area j}$$

The *bias* term captures how many MWs of local generation are typically required to offset a 0.01 Hz frequency shift. This ACE is measured in MW, and it will roughly equal the mount of generation shortfall in a given control area. Because of the governor controls described above, an imbalance in area j may be first met by a load-following unit outside of area j. This will be reflected in ACE_j as a frequency decline and a net scheduled import, while the area(s) supplying the new demand (or replacing the lost supply) in j will measure **[3-17]** a frequency decline and a net export. Exports have the opposite sign of imports, so these ACE measurements will be approximately zero outside of area j. This reveals which area needs to make adjustments, without having to evaluate the state of each and every supply or demand bus within each control area. The AGC system adjusts the setpoints of the governors on plants flint are participating in load-following and frequency regulation to restore each ACE to zero. Tiffs also brings frequency back to 60 Hz.[11]

Computers and electronic telemetry equipment are used to make these kinds of system observations and to help the system controller to maintain economic dispatch of the generators for modest changes in load. These computers are

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[11]In fact, restoring ACE to zero may not cause frequency to equal precisely 60 Hz, in part because of inaccuracies in estimating control area biases. As a result, utilities may find that a system clock gains or loses a small amount of time over the course of a day, indicating that some inadvertent interchange has occurred. This is generally corrected in kind with subsequent MWs rather than monetary payments. See Wood and Wallenberg, 1984, pp. 291-354, for a discussion of AGC and interchange management.

based at control area centers, of which there were 154 in the U.S. as of 1993.

For large changes in load, such as might arise unexpectedly due to a forced outage or a lighting strike that disables a portion of the transmission network, human anticipation and astute, timely operator intervention are required. The primary defense against such contingencies is to maintain buffers of reserve generation and transmission capacities sufficient to absorb the most severe potential disruptions to the system. A system capable of automatically adapting to any single contingent disruption, i.e. of adjusting without further loss of lines or loads to a new supply-demand balance at 60 Hz, is said to be *secure*.

The design of unbundled electric power services and open access protocols must be sensitive to the fact that generation operations mid transmission control are intimately related. The boundary between the two functions is not a precise one. Generators sometimes have to be adjusted to protect the transmission system, and transmission transactions such as wheeling obligations may alter the security of network operations. Analytically, determining how many MW of transmission flow capacity reserves are required for security and how generation and wheeling can be scheduled to achieve a pattern of power flows consistent with the needed transmission reserve margins requires modeling techniques like those described in the next chapter.

Robert C. McDiarmid *
Cynthia S. Bogarad
Peter J. Hopkins
Spiegel & McDiarmid
1350 New York Ave., NW
Washington, D.C. 20005
(202) 829-4000

Counsel for Respondent
Transmission Access Study Group

Charles G. Cole *
David B. Raskin
Alice E. Loughran
Steptoe & Johnson LLP
1330 Connecticut Ave., N.W.
Washington, D.C. 20036
(202) 429-6270

Counsel for Respondent
Edison Electric Institute

* COUNSEL OF RECORD

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IN THE

Supreme Court of the United States

PEOPLE OF THE STATE OF NEW YORK AND THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

ENRON POWER MARKETING, INC.,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF ENRON POWER MARKETING, INC. AS PETITIONER IN NO. 00-809

JEFFREY D. WATKISS
BRACEWELL & PATTERSON, L.L.P.
2000 K Street, N.W.
Suite 500
Washington, D.C. 20006
(202) 828-5800

JOSEPH R. HARTSOE
SARAH NOVOSEL
ENRON CORPORATION
1775 I Street, N.W.
Washington, D.C. 20006
(202) 828-3360

LOUIS R. COHEN
Counsel of Record
JOSEPH E. KILLORY, JR.
JONATHAN J. FRANKEL
IJAY PALANSKY
MICHAEL PLOTNICK
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, D.C. 20037-1420
(202) 663-6000

Counsel for Petitioner Enron Power Marketing, Inc.

5 PM

QUESTIONS PRESENTED IN NO. 00-809

Whether the Federal Energy Regulatory Commission (FERC) has jurisdiction under the Federal Power Act (FPA), 16 U.S.C. §§ 792 *et seq.*, to regulate all transmission of electric energy in interstate commerce, including interstate transmission of electric energy that is sold to retail customers at a "bundled" price.

Whether FERC had jurisdiction and the obligation under the FPA to eliminate pervasive "undue discrimination" in the provision of interstate electric energy transmission services by requiring transmission-owning utilities to provide interstate transmission services on the same terms to all users, for all interstate transmissions, including transmissions bundled with retail sales.

Whether the court of appeals erred in ruling that FERC had discretion to interpret the FPA as denying FERC the necessary jurisdiction to remedy the undue discrimination it had found in the provision of interstate transmission.

PARTIES TO THE PROCEEDING

The list of parties before the court of appeals is set forth at No. 00-809 Pet. App. 683a to 688a.

RULE 29.6 STATEMENT

Enron Corp. is the only publicly held company owning 10% or more of petitioner's stock. The following companies are the parent companies of petitioner:

Enron Corp.

Enron North America Corp.

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In The Supreme Court of the United States

Nos. 00-568 & 00-809

PEOPLE OF THE STATE OF NEW YORK AND THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

ENRON POWER MARKETING, INC.,
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v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF ENRON POWER MARKETING, INC. AS PETITIONER IN NO. 00-809

OPINION BELOW

The opinion of the United States Court of Appeals for the District of Columbia Circuit is reported at 225 F.3d 667 (D.C. Cir. 2000) and reprinted at No. 00-809 Pet. App. 3a to 121a. Federal Energy Regulatory Commission (FERC) Order No. 888 is reported at F.E.R.C. Stats. & Regs. ¶ 31,036, 61 Fed. Reg. 21,540 (1996). FERC's rehearing

decisions, Order No. 888-A and Order No. 888-B, are reported respectively at III F.E.R.C. Stats. & Regs. ¶ 31,048, 62 Fed. Reg. 12,274 (1997), and 81 F.E.R.C. ¶ 61,248, 62 Fed. Reg. 64,688 (1997). Relevant portions of FERC Orders Nos. 888 and 888-A and FERC's Notice of Proposed Rulemaking (NOPR), F.E.R.C. Stats. & Regs. ¶ 32,514, 60 Fed. Reg. 17,662 (1995), are reprinted at No. 00-809 Pet. App. 125a to 644a.

JURISDICTION

The court of appeals entered its judgment on June 30, 2000, and issued its order denying a timely filed petition for rehearing on August 22, 2000. On November 20, 2000, Enron Power Marketing, Inc. (Enron), filed a timely petition for a writ of certiorari pursuant to 28 U.S.C. § 2101(c) and S. Ct. R. 13. That petition, No. 00-809, was granted by the Court on February 26, 2001. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTES AND RULES INVOLVED

Sections 201, 205, 206, 211, 212, 213, and 313 of the Federal Power Act (FPA), 16 U.S.C. §§ 824, 824d, 824e, 824j, 824k, 824*l* and 825*l*, are reprinted in the Appendix at No. 00-809 Pet. App. 652a to 681a.

Sections 1, 4, and 5 of the Natural Gas Act (NGA), 15 U.S.C. §§ 717, 717c, and 717d, are reprinted in the Appendix at No. 00-809 Pet. App. 645a to 651a.

Relevant portions of FERC Orders Nos. 888 and 888-A are reprinted in the Appendix at No. 00-809 Pet. App. 125a to 551a.

STATEMENT

This case concerns the authority and obligation of the Federal Energy Regulatory Commission (FERC) to remedy what FERC itself called "the single greatest impediment to competition" in the electric industry. NOPR at 33,049, Pet. App. 558a.[1] In the orders under review, FERC found that vertically integrated utilities that own and control major portions of the interstate transmission grids regularly discriminate against competing power suppliers, denying them equal access to the high voltage lines that carry electricity from generation facilities to local distribution facilities. To remedy this undue discrimination, as it is required to do by the Federal Power Act (FPA), FERC ordered all public utilities to publish an "open access transmission tariff" (OATT) and take transmission for their own *wholesale* sales and *un*bundled retail sales under the same terms as other users. But FERC determined that it lacked jurisdiction to apply this requirement to transmissions sold with generation and distribution at retail for a single "bundled" charge. FERC's failure to extend the OATT to such bundled retail transmissions leaves the undue discrimination unremedied in the market segment that accounts for about 60% of all pertinent interstate transmissions. The result is contrary to FERC's express obligations under the FPA and poses a serious threat to coherent regulation of the Nation's interstate transmission grids.

A. The Electric Industry

The electric industry depends on three kinds of facilities: generation facilities that produce electric energy; distribution

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[1] All citations in this brief to "Pet. App." are to the Petitioner's Appendix filed with Enron's Petition for a Writ of Certiorari in No. 00-809.

facilities that deliver electric energy to end users; and transmission facilities that carry electricity at high voltages from the generation facilities to the distribution facilities.[2] Today, the transmission facilities in every state (except Alaska, Hawaii, and part of Texas) interconnect into two large reticulated grids, the Eastern and Western Interconnections. *See* Steven M. Kramer & Bret A. Sumner, *Electric Reliability in North America: Cross-Border Implications*, 14 Nat. Resources & Env't 81, 82 (1999) (Kramer & Sumner); *see also* Order No. 888 at 31,781, Pet. App. 305a n.541.

The largest segments of the interstate grids in each state are owned by the vertically integrated public utilities that have traditionally provided electricity to their local customers (their "native loads") on a regulated monopoly basis. *See* Order No. 888 at 31,652, Pet. App. 172a. The utilities use these facilities for bulk transmissions of the electric energy that they sell either at wholesale (i.e., to entities that in turn resell) or at retail (i.e., to end users who receive electricity via the utilities' local distribution systems). Other power suppliers that compete against the vertically integrated utilities depend on the same facilities to carry electricity to their customers.

As an accounting and contractual matter, a utility's sales charges may be either "unbundled" or "bundled." That is, the utility may, by its own choice or pursuant to state law, either present separate charges for the electricity, the transmission service, and the delivery service, or it may "bundle" the costs associated with these separate services

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[2] Although the broad distinction between high voltage transmission facilities and low voltage distribution facilities is of long standing and generally understood, the exact line is a matter of definition. FERC supplied such a definition in Order No. 888 at 31,771, Pet. App. 282a-283a, and it is not at issue in this Court.

into a single line item charge.[3] At present, approximately 37% of pertinent retail sales were previously sold at wholesale, and almost 97% of all retail sales are made on a "bundled" basis.[4] Thus, the bundled retail sales that are the specific concern of No. 00-809 and this brief account for about 60% of the pertinent usage of the interstate grids.

These contractual and accounting arrangements, however, bear no resemblance to the physical behavior of electricity on the high voltage interstate grids. A quantity of electricity is not a discrete object that flows from a particular source to a particular buyer or user over a particular route, and a supplier generating electricity cannot prescribe the route over the grid that "its" electricity will follow.[5] Each

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[3] *See AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 394 (1999) (defining "unbundled" as "to give separate prices" for various components of the service rendered).

[4] In 1999, approximately 2.44 billion megawatt hours of electricity were sold at retail by FERC jurisdictional generators: 2.4 billion by investor-owned utilities (IOUs) plus 43 million by independent power producers (IPPs). *See* Energy Information Administration, United States Department of Energy (EIA), *Financial Statistics of Major U.S. Publicly Owned Electric Utilities 1999*, at 3 (2000); EIA, 2 *Electric Power Annual 1999*, at 87 (2000). At most, 915 million of these megawatt hours, or 37.5%, had previously been sold at wholesale. *Id.* (showing 545 million megawatt hours were available for resale by IOUs and 370 million megawatt hours were sold "to Utilities" by IPPs). About 76 million megawatt hours (3% of retail sales) were sold on an unbundled basis, with the remaining 97% sold on a bundled basis. *See* EIA, *Electric Sales and Revenue 1999*, at 3, 245, 255 (2000) (noting that total retail sales were generally made on a bundled basis, and showing transmissions of 76 million megawatt hours sold pursuant to "retail wheeling" programs, i.e., on an unbundled basis). In total, therefore, there are no wholesale or unbundled transmissions associated with almost 60% (1.45 billion of 2.44 billion megawatt hours) of all retail sales.

[5] Unlike, for example, a water supply system, no substance—only energy—flows through the grid, and its flow cannot be routed within the grid. *See Florida Power & Light Co.*, 37 F.P.C. 544, 546 (1967).

interconnection operates as a single pool of energy, into which generating facilities (wherever located) deposit electric energy, and from which customers (wherever located) draw it down.[6] Every connected use draws to some degree on every connected source and to some degree affects the state of the entire system. The frequency of electric energy in the grid is maintained at a standard level, generally 60 cycles per second (or a multiple thereof), by legal and physical arrangements affecting the entire grid and all sources and uses. *See Florida Power & Light Co.*, 37 F.P.C. 544, 548, 564-65 (1967). "[A] load change at any point will have an effect on the instantaneous generation and frequency at every point on the interconnected system." *Id.* at 565. A sudden surge of use in Boston, or a downed high voltage transmission line in New York, impacts electric operations in every state in the Eastern Interconnection. *See id.* at 548-50.

B. Statutory Background

In the early years of the Twentieth Century, in part because electricity could be produced in many places but could not be successfully transmitted over long distances without substantial losses, the electricity business was almost entirely local. *See Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 681 (D.C. Cir. 2000) (*TAPS*), Pet. App. 9a; Order No. 888 at 31,639, Pet. App. 141a. Vertically integrated utilities, mostly confined to single states, each generated, transmitted, and distributed their own electricity to

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[6] In this respect, the electricity network is very different from, for example, the telephone network. When one telephone caller dials another, the switches in the telephone network establish a dedicated circuit between them that remains open for the length of the call, and all communications between the callers travel over this fixed open pathway. By contrast, when a generating utility contracts with an end user to deliver electricity, nothing travels on any path between them: the utility generates an additional amount of electric energy for the grid, and the end user withdraws a corresponding amount of electric energy from the grid.

their own customers, selling it to them on a bundled basis. "The industry consisted of independent, unassociated, local units [but] its piecemeal and planless development resulted in an uneconomic division of territory, wasteful overlapping of facilities, and lack of engineering and economic unity." Memorandum of Oswald Ryan, General Counsel of the Federal Power Commission (FPC), and Dozier A. DeVane, Solicitor of the FPC (Ryan-DeVane Memorandum), in *Public Utility Holding Company Act of 1935: Hearings on S. 1725 Before the Senate Comm. on Interstate Commerce*, 74th Cong. 797 (1935) (*Hearings on S. 1725*).[7] In 1935, only a "fraction of the nation's electric systems were interconnected in interstate networks." *Federal Power Act Amendments of 1967, Hearings on H.R. 5348, H.R. 5637, H.R. 7799, H.R. 8426, H.R. 8919, H.R. 9174 Before the Subcomm. On Communications and Power of the House Comm. on Interstate and Foreign Commerce*, 90th Cong. 4 (1967) (*1967 Hearings*) (statement of Lee C. White, Chairman, FPC). Gradually, however, the utilities found that interconnecting with other utilities enabled them to sell their power in other markets and draw on other generators' electricity to meet local demand, which allowed them to increase the reliability and profitability of their services.

Congress adopted the Federal Power Act to regulate this growing network arrangement. As originally enacted, the FPA took three steps pertinent to the present case. First, the FPA gave the Federal Power Commission (FERC's predecessor) jurisdiction over all "transmission of electric energy in interstate commerce" and all "facilities" used for such transmission. 16 U.S.C. § 824(b)(1). It defined "[e]lectric energy in interstate commerce" as energy "transmitted from a State and consumed at any point outside thereof." 16 U.S.C. § 824(c).

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[7] The Ryan-DeVane Memorandum summarizes the history of the industry up to 1935.

Second, the FPA gave the FPC jurisdiction over "the sale of electric energy *at wholesale* in interstate commerce." *Id.* § 824(b) (emphasis added). The phrase "at wholesale" was applied to *sales* in order to provide a "bright line" between sales transactions subject to FPC jurisdiction and sales transactions regulated by the states.[8] The qualifier "at wholesale" was not applied to *transmissions* in interstate commerce, all of which were made subject to the Commission's jurisdiction. *See* Order No. 888 at 31,969, Pet. App. 338a ("statute . . . makes no distinction between wholesale transmission and retail transmission"); *FPC v. Louisiana Power & Light Co.*, 406 U.S. 621, 636 (1972) (*LP&L*) (interpreting the parallel provision of the NGA, 15 U.S.C. §§ 717 *et seq.*).[9]

Third, the FPA commanded the FPC to remedy "undue discrimination." Specifically, section 205 of the FPA, 16 U.S.C. § 824d, bars any public utility, "with respect to any transmission or sale subject to the jurisdiction of the Commission," from "grant[ing] any undue preference or advantage to any person or subject[ing] any person to any

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[8] *See FPC v. Southern California Edison Co.*, 376 U.S. 205, 211 (1964). As the Court there explained, with respect to sales, Congress was responding to the Court's decision in *Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927), holding that the Commerce Clause barred states from regulating interstate wholesales. The wholesale/retail "bright line" served to distinguish jurisdictional from nonjurisdictional sales without case-by-case adjudication of Commerce Clause issues. There is no comparable distinction with respect to interstate transmissions, all of which are part of interstate commerce and have been subject to federal regulation since 1935. There is therefore no need for a bright line with respect to transmissions.

[9] All of the provisions of Part II of the FPA pertinent to this case are "in all material respects substantially identical" to parallel provisions of the NGA. *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981) (internal quotation omitted). This Court has an "established practice of citing interchangeably decisions interpreting the pertinent sections of the two statutes." *Id.*

undue prejudice or disadvantage," *id.*, and requires each utility to file tariffs setting forth its "practices," *id.* § 824d(c). Section 206(a), 16 U.S.C. § 824e(a), directs FERC, whenever it determines that a practice is "unjust, unreasonable, unduly discriminatory or preferential," to cure the discrimination: FERC "shall determine the just and reasonable . . . practice . . . to be thereafter observed and in force, and shall fix the same by order."

After the adoption of the FPA, two further developments, intertwined with changes in law, set the stage for the present case. First, the process of interconnection accelerated, spurred by ever-greater needs for more reliable electricity service and by technological developments that made it possible to transmit electricity at high voltages over long distances without unacceptable losses. *See* Order No. 888 at 31,641, Pet. App. 147a. By 1967, "[i]nterconnections, direct and indirect, among utilities [were] a far more vital part of the industry's operations." *See 1967 Hearings* at 118 (statement of Lee C. White, Chairman, FPC).[10] Commentators in 1967 accurately predicted that interconnections would become "still more vital in the future." *Id.* Today, all high voltage electric transmission lines (other than those in the two non-contiguous states and part of Texas) are connected into one or the other of the interstate grids. *See* Kramer & Sumner, *supra* at 82; Order No. 888 at 31,781, Pet. App. 305a n.541. The volume of transmissions subject to FERC's jurisdiction has thus increased many fold, not because of any change in the statute (or its interpretation) but because real-world changes in the physical structure of the electric industry have brought almost all transmission within the jurisdiction defined in 1935. These changes have "made [p]hysically isolated

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[10] *See Florida Power & Light*, 37 F.P.C. at 557 (Carver, Commissioner, dissenting) (noting that more than 90% of transmission facilities were by then interconnected).

systems . . . a thing of the past." Order No. 888 at 31,641, Pet. App. 147a.[11]

A second, closely related major development since 1935 has been the rise of competition among sources of electric energy. Spurred by the energy shortages of the 1970s, Congress adopted the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. §§ 2601 *et seq.* (PURPA), amending the FPA to encourage the construction and more efficient use of electric generation facilities. PURPA achieved this by requiring traditional utilities to buy power from industrial cogenerators and certain generators using renewable energy sources. *See* Order No. 888 at 31,642, Pet. App. 148a & n.36. These new suppliers began to compete with traditional utility generators. *See* 16 U.S.C. §§ 2601, 2611; Order No. 888 at 31,642, Pet. App. 147a-148a. This small step launched a transformation of the industry such that "[i]n 1992, for the first time, generating capacity added by independent producers exceeded capacity added by utilities." Order No. 888 at 31,643, Pet. App. 151a (citation omitted). Other competing sources also grew, including many traditional utilities that became marketers of electricity outside their "native" areas. *See id.* at 31,639, 31,641, Pet. App. 141a, 147a. Where the generation, transmission, and delivery of power were all once largely local activities, generation and marketing of power became the subjects of increasingly intense interstate competition. *See id.* at 31,635, 31,645-46, Pet. App. 131a-132a, 156a-157a.

To compete, however, these new sources of electric power needed to be able to deliver power from the generators to either wholesale customers or retail distribution points, which meant purchasing transmission services from their chief competitors, the traditional vertically integrated utilities

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[11] *See also Pub. Serv. Co. of New Mexico*, 25 F.E.R.C. ¶ 61,469, at 62,029, 62,034 (1983).

that continued to own a large percentage of the interstate grids.[12] Congress responded by enacting the Energy Policy Act of 1992 (EPAct), codified in pertinent part at 16 U.S.C. §§ 824j-824m, which, in addition to expanding the ranks of competitive generators to include non-utility "exempt wholesale generators," gave FERC greater authority to order transmission-owning utilities to provide transmission service to competing power suppliers. *See* 16 U.S.C. §§ 824j, 824k; Order No. 888 at 31,644-45, Pet. App. 154a. Specifically, the EPAct "amended section 211 [and 212] of the FPA to give the Commission broader authority to order wheeling [transmission of power for another supplier] on a case-by-case basis." Order No. 888 at 31,673, Pet. App. 191a. As FERC noted, however, this amendment "left unaltered the authorities and obligations of the Commission under sections 205 and 206 . . . to remedy undue discrimination." *Id.* at 31,673, Pet. App. 192a.

C. The FERC Orders at Issue

Vertically integrated utilities that own transmission facilities have the incentive and (absent regulation) the ability to discriminate in crippling ways against competing power suppliers. For example, utilities can reserve their transmission facilities for their own sales and force competing suppliers to make more expensive alternative transmission arrangements, and the utilities can manipulate the transmission "curtailment" process to bar competitors' power from the system during periods of system overload. *See Northern States Power Co. v. FERC*, 176 F.3d 1090 (8th Cir. 1999). These and other forms of discrimination have

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[12] FERC found, "[T]hese entities [new suppliers of power] needed transmission service in order to compete in electricity markets." Order No. 888 at 31,643, Pet. App. 150a. In order for there to be competitive power markets, "all wholesale buyers . . . must have equal access to the transmission grid." NOPR at 33,049, Pet. App. 558a.

state-versus-state impacts: customers in one state frequently are served by generating facilities in (and transmission lines that pass through) other states, and the ability of transmission monopolists to favor their native load can force customers in other states to rely on more circuitous and costly transmission arrangements or to forgo the transactions altogether. To use a very rough analogy (because, among other things, electric energy does not behave like solid objects moving from point to point over fixed paths) it is as if Wal-Mart, Safeway, and other large retailers each owned large segments of the interstate highway system used to transport goods in bulk to their retail stores, and they were able to charge others more for the use of their segments of the highway system than they implicitly charge themselves, and could force other users off the highway system onto inefficient and more costly back roads (or off the road entirely) whenever traffic became congested.

In Order No. 888 and, after rehearing, Order No. 888-A, FERC found that the traditional utilities that own much of the interstate transmission grid were in fact engaged in widespread and entrenched undue discrimination against competing users. FERC further found that the case-by-case authority to order transmission provided by the EPAct amendments to sections 211 and 212 was insufficient to remedy such discrimination and that it must use its broader powers under sections 205 and 206. Then, however, FERC, virtually without explanation, held itself powerless to address the vast majority of the problem.

Findings of Undue Discrimination. FERC found that the utilities that own portions of the transmission grid have inherent incentives to discriminate against other suppliers and are actually doing so:

> [U]tilities owning or controlling transmission facilities possess substantial market power; . . . as profit maximizing firms, they have and will continue to exercise that market power in order to

> maintain and increase market share, and will thus deny their wholesale customers access to competitively priced electric generation; and . . . these unduly discriminatory practices will deny consumers the substantial benefits of lower electricity prices.

NOPR at 33,052, Pet. App. 566a. Structural characteristics in the industry "make it inevitable that [the transmission-owning utilities] will act in their own self-interest to the detriment of others by refusing transmission and/or providing inferior transmission to competitors." Order No. 888 at 31,682, Pet. App. 214a; Order No. 888-A at 30,210, Pet. App. 436a. FERC found that vertically integrated utilities have in fact acted on these incentives to harm competitors and competition, as illustrated in the record by an "array of allegations and circumstances raised by customers in individual cases over the years." Order No. 888-A at 30,210, Pet. App. 435a. Examples in the record include refusals to transmit, dilatory tactics amounting to refusals to transmit, and refusals to offer comparable service. *See* Order No. 888 at 31,919-26, Pet. App. 315a-331a.

FERC's (Incomplete) Remedy. FERC understood that under the FPA "it is [FERC's] duty to eradicate unduly discriminatory practices." *Id.* at 31,682, Pet. App. 214a. In this case, FERC determined that a broad remedy was necessary because there was "more than sufficient reason to believe that transmission monopolists . . . will continue to engage in unduly discriminatory practices, unless we fashion a remedy to eliminate their ability and incentive to do so." *Id.* at 31,683, Pet. App. 216a-217a.

The remedy FERC fashioned was "functional unbundling." FERC required every public utility to adopt an "open access transmission tariff" (OATT) dictating the terms of all transmissions for wholesale sales and *un*bundled retail

sales.[13] *Id.* at 31,654, 31,781, Pet. App. 178a, 306a. The terms covered by the tariff include price and other conditions of usage, such as rules of priority when system conditions require curtailment of transmission. *See id.* at 31,721-44, 31,749-50, Pet. App. 254a-264a, 276a-278a; Order No. 888-A at 30,278-79, Pet. App. 456a-60a. FERC also required each utility to "state separate rates for wholesale generation, transmission, and ancillary services." Order No. 888 at 31,654, Pet. App. 178a. In sum, the OATT established that when a utility is selling at wholesale, or at retail on an unbundled basis, it must take transmission for itself on the same terms it offers to others and must reflect the cost of this transmission separately in its bill to the customer.

FERC determined, however, that it did not have authority to extend its functional unbundling remedy to transmissions for bundled retail sales. As a result, the FERC orders permit a vertically integrated utility to transmit its bundled retail sales at no explicit charge; to reserve and schedule its uses of its transmission facilities for such bundled retail sales in ways that freeze out competing uses; and, when physical conditions require imposition of transmission curtailment, to give preference to its own use of the transmission facilities for its own bundled retail sales.

Under FERC's cramped vision of its authority, the open access remedy excludes the roughly 60% of pertinent transmissions that are bundled with retail sales. *See supra* note 4. FERC had previously recognized that failure to

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[13] FERC initially stated that its rule would apply where the utility is either purchasing or selling at wholesale. *See* Order No. 888 at 31,654, Pet. App. 178a. But, on rehearing, FERC dropped the reference to wholesale purchases. Accordingly, if a utility buys bulk power and resells it at retail on a bundled basis, the OATT requirements do not apply. *See* Order No. 888-A at 30,216-17, Pet. App. 451a-453a. The utility is thus freed from the OATT when using the transmission system to supply its own retail needs.

require utilities to take transmission for their retail sales under the OATT "raises the possibility that . ... transmission service for retail purposes will be superior" to wholesale. NOPR at 33,081-82, Pet. App. 634a. But in Order No. 888, FERC nevertheless concluded that "[a]lthough the [functional] unbundling of retail transmission and generation . . . would be helpful in achieving comparability, we do not believe it is necessary. In addition, it raises numerous difficult jurisdictional issues . . . ." Pet. App. 235a.

FERC offered no explanation in Order No. 888 of its "belie[f]" that application of the OATT to bundled retail sales was not "necessary." In its order on rehearing, Order No. 888-A, FERC did not reassert that regulating transmission for unbundled retail sales was not "necessary"; it relied instead solely on the jurisdictional point. *See* Pet. App. 453a-456a. As to that point, FERC correctly noted that "[u]nlike our jurisdiction over *sales* of electric energy, which section 201 of the FPA specifically limits to sales at wholesale, the statute does *not* limit our *transmission* jurisdiction over public utilities to wholesale transmission." Order No. 888 at 31,781, Pet. App. 305a (emphasis added). Accordingly, FERC said, "when a retail transaction is broken into two products that are sold separately . . . we believe the . . . unbundled transmission service involves *only* the provision of 'transmission in interstate commerce' which, under the FPA, is exclusively within the jurisdiction of [FERC]." *Id.*, Pet. App. 306a. But, in a direct about-face, FERC then said, "when transmission is sold at retail as part and parcel of the delivered product called electric energy, the transaction is a sale of electric energy at retail" and, thus, FERC implied, beyond the agency's jurisdictional reach. *Id.* FERC did not even attempt to explain why the bundling of the cost of electricity and the cost of transmission as an accounting and invoicing matter should be legally determinative of its jurisdiction over the activity of interstate transmission.

D. Proceedings in the D.C. Circuit

On petitions for review, the D.C. Circuit upheld FERC's orders against challenges both that they exceeded FERC's jurisdiction and that they did not go far enough to carry out FERC's statutory obligations to remedy undue discrimination. *See Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 681, 687 (D.C. Cir. 2000), Pet. App. 8a-9a. 20a-21a. The State of New York and other parties contended that FERC has no jurisdiction over interstate transmission for *any* retail sales, even unbundled ones; the D.C. Circuit rejected this contention, holding that the Act confers jurisdiction over unbundled interstate transmission of electric energy whether it is then sold at wholesale or retail. *See* Pet. App. 34a-35a. Other parties challenged FERC's authority to remedy the undue discrimination it had found by requiring utilities to grant open access to their facilities used for interstate transmissions, arguing that the FPA did not confer such jurisdiction on FERC; the D.C. Circuit also rejected this argument, finding that FERC had "authority under FPA §§ 205 and 206 to require open access as a generic remedy to prevent undue discrimination." Pet. App. 20a-21a.[14]

Conversely, Enron and other parties challenged FERC's failure to provide a complete or adequate remedy for the undue discrimination FERC had found. Enron noted that most electric energy carried over local utilities' transmission facilities is carried for bundled retail sales, and Enron argued

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[14] The Board of Water, Light and Sinking Fund Commissioners of The City of Dalton, Georgia (Dalton) and others argued that the record before FERC did not support its finding of undue discrimination and, therefore, FERC had not satisfied one of the legal prerequisites for prescribing any remedy under section 206. The D.C. Circuit disagreed, concluding that the record supported FERC's finding of undue discrimination that needed a remedy. *See* Pet. App. 21a-23a. This Court denied Dalton's petition for a writ of certiorari. No. 00-800.

that FERC's failure to subject such transmission to the OATT would allow vertically integrated utilities to continue to discriminate in favor of themselves and their own retail sales. Citing the unambiguous text of section 201(b) and this Court's holding in *FPC v. Louisiana Power & Light Co.*, 406 U.S. 621 (1972) (*LP&L*), Enron argued that FERC has jurisdiction to regulate all interstate transmission of electric energy, regardless of whether that energy is then sold at wholesale or retail, unbundled or bundled. Enron further argued that FERC was required by the statute to remedy all of the undue discrimination it found, including discrimination in transmissions bundled with retail sales. *See* 16 U.S.C. §§ 824d, 824e.

The D.C. Circuit rejected Enron's arguments with respect to bundled retail sales. The court conceded that the FPA could be read to assign FERC jurisdiction over transmission for bundled retail sales: "A regulator could reasonably construe transmissions bundled with generation and delivery services and sold to a consumer for a single charge as . . . transmission services in interstate commerce [within FERC's jurisdiction]." Pet. App. 35a. But the court ruled that FERC's finding that it lacked jurisdiction over bundled interstate transmissions was "a permissible policy choice" entitled to deference under *Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 842-43 (1984). The court said:

> FPA § 201 gives FERC jurisdiction over transmissions in interstate commerce and sales at wholesale[;] the statute also clearly contemplates state jurisdiction over local distribution facilities and retail sales. The statute is much less clear about exactly where the lines between those activities are to be drawn. . . . FERC's decision to characterize bundled transmissions as part of retail sales subject to state jurisdiction therefore represents a statutorily

> permissible policy choice to which we must . . . defer under *Chevron*.

Pet. App. 35a.

SUMMARY OF ARGUMENT

FERC's decision that it did not have jurisdiction to apply the OATT to transmissions for bundled retail sales was contrary to law. The FPA gives FERC jurisdiction over "transmission of electric energy in interstate commerce." There is no exception from this branch of FERC's jurisdiction for electricity that is sold at retail, or for electricity that is sold on a bundled basis. The FPA also commands FERC, upon finding "undue discrimination," to fully remedy the problem. FERC did find undue discrimination in this case, and it prescribed a rule that addressed a fraction of the problem, but it abdicated its responsibility to remedy the remainder.

I. The FPA is clear that FERC's jurisdiction over interstate transmission is plenary and not limited to transmission for wholesale or unbundled sales. Moreover, this Court has interpreted the nearly identical parallel provision of the Natural Gas Act to confer just such plenary jurisdiction over interstate transportation of natural gas. The legislative history also supports this interpretation.

The D.C. Circuit's suggestion that the scope of FERC's jurisdiction presented a "policy choice" ignores the statute and mistakes the relationship between transmission and sale. The court assumed that FERC was required to choose between treating transmissions for bundled retail sales as "interstate transmissions" *or* as components of a bundled retail sale, but such transmissions are clearly *both*, legally as well as factually. Transmission of energy across state borders does not cease to be interstate transmission merely because it is bundled with a sale of energy as an invoicing matter. In addition, FERC regulation of the terms of

interstate transmission is entirely consistent with state regulation of the terms of retail sale, even though the former is a component of the latter: the state is simply required to recognize the FERC-approved terms of interstate transmission (just as it recognizes other FERC determinations of matters within FERC's jurisdiction) when the state sets retail rates and other retail terms.

It is important to confirm FERC's jurisdiction over all interstate transmission of electricity because such transmission is in interstate commerce, and no state can regulate it constitutionally or successfully. This Court has traditionally followed an "engineering and scientific" approach to determine whether a transmission is interstate. Transmission facilities in every state (except Alaska, Hawaii, and part of Texas) are connected into one of two interstate grids. As a result, even if the contractual buyer and seller of a quantity of electricity are located in the same state, the transmission of electricity needed to consummate the sale uses the entire interstate grid and is in interstate commerce. State-by-state regulation of various sections or various uses of the interstate grids would be unworkable as both a legal and practical matter and would be inconsistent with Congress's objective of promoting competition and providing cheap and reliable power to every region of the Nation.

II. FERC is required to act to remedy the undue discrimination it found, and may not exempt interstate transmissions bundled with retail sales. FERC found pervasive undue discrimination by the utilities that own transmission facilities that comprise portions of the interstate grids: such utilities have strong incentives to prefer their own use of the facilities over uses by competing suppliers or to serve other customers, and they have acted on these incentives. The utilities' have denied their competitors the use of needed transmission facilities, denied competitors the ability to offer power of equal reliability to that provided by

the utilities, and discriminated between customers of different classes and in different states.

FERC's statutory obligation to remedy such undue discrimination is explicit and mandatory. Neither of FERC's excuses for failing to carry out this mandate is correct in law, fact, or policy. FERC's suggestion (later withdrawn) that it was not "necessary" to apply the open-access terms and conditions to transmission for bundled retail sales was wholly unexplained and contrary to the facts FERC found in Order No. 888. The bundled interstate transmissions that FERC left untouched constitute almost 60% of the pertinent transmissions on the interstate grids, and there is no reason why undue discrimination to favor bundled retail sales is any less likely, any less important, or any more easily remedied without the OATT than any other part of the discrimination FERC found. FERC's ultimate excuse that the statute could be read to deny it the needed jurisdiction is an impermissible interpretation of unambiguous statutory language and was an abdication of its statutory responsibilities.

ARGUMENT

I. FERC HAS JURISDICTION OVER ALL INTERSTATE TRANSMISSIONS OF ELECTRIC ENERGY, WHETHER THE ENERGY IS SOLD AT WHOLESALE OR RETAIL, BUNDLED OR UNBUNDLED.

FERC's interpretation of its jurisdiction over interstate electric transmissions under the FPA—finding no jurisdiction when the cost of the transmission is bundled with the cost of power at retail—is contrary to the plain language of the statute and this Court's interpretation of nearly identical language in the parallel provision of the Natural Gas Act. The court of appeals asserted that FERC had made a "permissible policy choice," but the statute neither requires nor permits a choice: FERC's jurisdiction over the terms of

interstate transmissions is both mandatory and perfectly consistent with state regulation of the terms of retail sales. Particularly in view of the important effects of the terms of interstate electric transmission on interstate commerce, the D.C. Circuit's affirmance of FERC's abdication of jurisdiction was a serious error.

A. The Federal Power Act Unambiguously Gives FERC Jurisdiction Over All Interstate Transmissions of Electric Power, Whether for Wholesale or Retail Sale, and Whether Bundled or Unbundled.

Section 201(b) of the FPA, 16 U.S.C. § 824(b), explicitly gives FERC jurisdiction, without any stated limitation or qualification, over all interstate transmissions of electric energy. Both FERC and the D.C. Circuit correctly ruled that this section grants jurisdiction over transmissions for both wholesale and retail sales, rejecting the contrary views of various parties. But then both FERC and the D.C. Circuit read into section 201(b) an exception for transmissions that are bundled at retail, thus excluding the majority of pertinent interstate transmissions from Order No. 888's open access remedy. This was error: both the agency and the court were bound by the plain meaning of the statute. *Chevron*, 467 U.S. at 842-43.[15]

1. FERC Has Jurisdiction Over Transmissions for Both Wholesale and Retail Sales.

Section 201(b) grants FERC jurisdiction over (a) "the transmission of electric energy in interstate commerce," and

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[15] FERC itself found that the statutory grant of federal jurisdiction over all interstate transmissions of electric energy is unambiguous. *See* Order No. 888 at 31,781, Pet. App. 305a ("[S]ection 201 of the FPA, *on its face* . . . gives the Commission jurisdiction over transmission in interstate commerce . . . without qualification.").

(b) "the sale of electric energy at wholesale. . . ." 16 U.S.C. § 824(b). Section 201(a), 16 U.S.C. § 824(a), contains the same two distinct phrases. The words "at wholesale" do not appear in the phrase describing transmission and do not limit FERC's jurisdiction over transmission.

FERC and the D.C. Circuit correctly concluded that FERC's jurisdiction over interstate transmission extends to transmission for retail as well as wholesale sales. FERC held, "Unlike our jurisdiction over sales of electric energy, which section 201 specifically limits to sales at wholesale, the statute does not limit our transmission jurisdiction over public utilities to wholesale transmission . . . ." Order No. 888 at 31,781, Pet. App. 305a. The D.C. Circuit accepted this finding. *See* Pet. App. 35a.

This interpretation is also compelled by this Court's interpretation of the nearly identical parallel provision of the Natural Gas Act (NGA), 15 U.S.C. § 717b.[16] Section 1(b) of that statute gives FERC jurisdiction over "[1] the transportation of natural gas in interstate commerce, [and] [2] the sale in interstate commerce of natural gas for resale." In *LP&L*, the Court explained that "[e]ach of these is an independent grant of jurisdiction and, though the Act's application to 'sales' is limited to sales of interstate gas for resale, the Act applies to interstate 'transportation' regardless of whether the gas transported is ultimately sold retail or wholesale." 406 U.S. at 636. In keeping with the Court's "established practice of citing interchangeably decisions interpreting the pertinent sections of the two statutes," *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981), the *LP&L* decision would be controlling even if the

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[16] The only differences in the language are that the NGA refers to "transportation of natural gas" rather than "transmission of electric energy," and refers to the "sale in interstate commerce of natural gas for resale" rather than "sale of electric energy at wholesale in interstate commerce."

FPA's statutory language were not itself clear. *See Maislin Indus., U.S., Inc. v. Primary Steel, Inc.*, 497 U.S. 116, 131 (1990) ("Once [this Court has] determined a statute's clear meaning, [it] adhere[s] to that determination under the doctrine of *stare decisis*, and we judge an agency's later interpretation of the statute against our prior determination of the statute's meaning.").

The legislative history of the FPA confirms this interpretation. For example, the Senate Report on the bill that contained section 201 stated, "Jurisdiction is asserted . . . over *all* interstate transmission lines whether or not there is a sale of the energy carried by those lines . . . ." S. Rep. No. 74-621, at 48 (1935) (emphasis added). Congress rejected attempts to limit federal transmission jurisdiction to transmissions for wholesales. For example, representatives of the National Association of Railroad and Utility Commissioners (NARUC, predecessor of a petitioner in No. 00-568) attempted to persuade Congress to limit federal transmission jurisdiction to the small category of transmissions (then one to two percent of all transmissions of electric energy) for wholesales. *See Public Utility Holding Cos., Hearings on H.R. 5423 Before the House Comm. on Interstate and Foreign Commerce*, 74th Cong. 1612-13 (1935) (*Hearings on H.R. 5423*) (statement of H. Lester Hooker, Chairman of the Legislative Comm. of NARUC). NARUC proposed an amendment to section 201(b) stating, "[T]he provisions of this title shall apply only to the transmission and sale at wholesale of electric energy in interstate commerce . . . ." *See id.* at 1660 (statement of John E. Benton, General Solicitor of NARUC). Congress rejected this limiting language and enacted the broader jurisdictional grant still contained in section 201(b). As one witness summarized,

> Whether it be *wholesale or retail*, as I understand it, the transmission of the current from one State to another is interstate commerce. Now, what the

> consequence of that may be is an entirely different matter, but under this bill it is one of the reasons asserted for jurisdiction and I am merely reciting those reasons as part of my case.

Id. at 666 (statement of Preston Arkwright, President of Georgia Power Company) (emphasis added).

2. *FERC's Jurisdiction Over Interstate Transmissions for Retail Sales Is Not Limited to Transmissions That Are Unbundled for Billing Purposes.*

Section 201(b) contains no words limiting FERC's jurisdiction over retail transmissions to unbundled transmissions. Indeed, there is nothing in the statutory language suggesting that FERC's transmission jurisdiction is in any way qualified by or related to the terms on which the transmitted electric energy is sold. Moreover, this Court's interpretation of the parallel NGA provision in the *LP&L* case is again squarely on point. The gas sales at issue in *LP&L* were "direct" retail sales by the pipeline-owning utility, the equivalent of "bundled" retail sales by a transmission-owning electric utility. This Court rejected the contention that there was any exception from the FPC's transmission jurisdiction for direct sales. *See* 406 U.S. at 636-38. Neither FERC nor the Court may ignore the words of the statute or this Court's prior interpretation of them. *See Maislin Indus., U.S., Inc.*, 497 U.S. at 131.[17]

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[17] The specific issue in *LP&L* was whether the FPC had jurisdiction to impose, under conditions of temporary shortage of natural gas supply, an orderly plan of curtailment that would include direct retail sales. This Court reversed a court of appeals ruling that the FPC lacked jurisdiction to curtail deliveries to direct sales customers. *See* 406 U.S. at 636. In the present case, one very important feature of the mandated OATT is that when electric system overload conditions require curtailment of transmission, a transmission-owning utility may not discriminate in favor

The legislative history confirms that Congress understood that the FPC's jurisdiction over transmissions in interstate commerce would include transmissions for bundled retail sales. The committee report discussions of transmission in interstate commerce, over which FERC would have jurisdiction, contain no hint of any distinction between transmissions for unbundled and bundled sales. *See* S. Rep. No. 74-621, at 17, 19 (1935); H.R Rep. No. 74-1318, at 7, 27 (1935).

In the orders under review, FERC created an exception for transmission for bundled retail sales found nowhere in the language of the FPA. The D.C. Circuit characterized FERC's ruling as a "policy choice" and deferred to FERC. The court said,

> FPA § 201 gives FERC jurisdiction over transmissions in interstate commerce and sales at wholesale[;] the statute also clearly contemplates state jurisdiction over local distribution facilities and retail sales. The statute is much less clear about exactly where the lines between those activities are to be drawn. A regulator could reasonably construe transmissions bundled with generation and delivery services and sold to a consumer for a single charge as *either* transmission services in interstate commerce *or* as an integral component of a retail

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of its own retail customers and against other generating and marketing companies that have purchased "firm" transmission service. *See* Order No. 888 at 31,748-49, Pet. App. 274a-277a. One court of appeals has already held, erroneously, that FERC does not have the power to impose a curtailment plan that covers interstate transmissions for retail sales. *See Northern States Power Co. v. FERC*, 176 F.3d 1090 (8th Cir. 1999), *cert. denied*, 528 U.S. 1182 (2000). FERC opposed Enron's petition for a writ of certiorari in that case, No. 99-916, on the ground that the matter should await the D.C. Circuit's decision in the present case, and the petition was denied.

> sale. . . . FERC's decision to characterize bundled transmissions as part of retail sales subject to state jurisdiction therefore represents a statutorily permissible policy choice to which we must . . . defer under *Chevron*.

Pet. App. at 35a (emphasis added).

But there are no such "lines," and the "policy choice" posited by the court of appeals is an entirely false one that has no basis in the statute or fact. The transmissions at issue are *both* interstate transmissions of electric energy, as to which FERC has the authority and the duty to eliminate undue discrimination, *and* (if the utility elects to set a single bundled charge) components of state-regulated bundled retail sales. A transmission in interstate commerce does not cease to be an interstate transmission because of the manner in which the electricity is then sold.

There is nothing illogical or inappropriate about FERC's regulation of interstate transmission merely because its cost becomes a component of the price at which electricity is sold in a bundled retail sale regulated by a state. On the contrary, that is exactly the relationship between FERC regulation of wholesale prices and state regulation of retail prices. The price charged in a FERC-regulated wholesale transaction is a cost to the retailer, which must be recognized by the state regulator in fixing retail prices, but this is in no way inconsistent with the state's plenary jurisdiction over the retail sale as such. As this Court explained in *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 966 (1986), FERC establishes the terms, including price, of wholesales; the state then regulates the prices at which the retailer sells. But whether those retail prices are bundled or unbundled, the state regulator must "recognize a FERC-approved [wholesale] price as a reasonable cost for purposes of retail ratemaking." *Id.* at 973. In *Nantahala*, the principle was applied to the FERC-filed allocation of low- and high-cost wholesale power received by the retailer, but exactly the

same principle can—and must—be applied to the terms on which the retailer receives transmission service.

In sum, FERC's decision in this case to "characterize" some interstate transmissions as subject only to state regulation was contrary to the statute and an abdication of its statutory responsibility.[18]

B. FERC's Abdication of Jurisdiction Over Interstate Transmission for Bundled Retail Sales Is an Important Error, Because All Transmissions of Electric Energy on the Interstate Grids Are in Interstate Commerce.

The electric industry is by many measures the largest and most important industry in the United States, affecting every part of the economy and almost every part of private

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[18] Ironically, the D.C. Circuit had itself earlier explained one important reason why the FERC interpretation, rejected under the NGA in *LP&L* and reasserted under the FPA in the present case, is necessarily wrong. In *Mississippi River Transmission Corp. v. FERC*, 969 F.2d 1215 (D.C. Cir. 1992), the court ruled that FERC had jurisdiction to regulate a natural gas transportation rate "imbedded in" a bundled retail sale. *MRT*, 969 F.2d at 1219 n.4. Holding that FERC's authority over "such transactions is beyond dispute," the court explained that any other rule would invite manipulation by the utility, which would be able to choose its regulator simply by offering bundled or unbundled pricing of the same product and service:

> As far as the statute is concerned, there would have been no doubt of FERC's section 1(b) authority if MRT, instead of charging a bundled price, had charged separately for transporting the gas and for the gas itself. To accept MRT's position would therefore be tantamount to conferring on private parties the power to decide whether FERC could set the rate for interstate transportation. Private parties would have this power because it would be entirely up to them whether to structure a direct sale and interstate-transportation transaction in terms of a bundled price or separate charges.

Id. at 1217-18.

life. As FERC has at least partially recognized, establishing a transmission system capable of effectively meeting the Nation's energy needs depends on opening the interstate transmission grids to robust competition among suppliers of electricity. *See* Order No. 888 at 31,646, 31,652, Pet. App. 158a, 171a-172a; NOPR at 33,049, Pet. App. 558a; *see also TAPS*, 225 F.3d at 681-82, Pet. App. 10a. But if the decision below stands, no regulatory body, federal or state, will have the authority to eliminate undue discrimination in interstate transmissions for bundled retail sales.

The need for federal regulation of interstate transmission results in part from the physical behavior of electricity in the grid. Electricity does not follow the paths implied in contracts between buyers and sellers or in utility rate schedules. On the contrary, the electric energy on a grid can be conceptualized as a pool to which every connected generation facility contributes and from which every connected user draws.[19] Accordingly, because the transmission facilities in every state except Alaska, Hawaii, and part of Texas are interconnected into one of the two grids, every transmission over any part of either grid is in interstate commerce. Moreover, every public rule or private procedure for the use of any portion of the interstate grid to some degree affects every supplier's and every user's costs and ability to sell or receive reliable power. "Undue discrimination" by the owner of a part of the grid must therefore be eliminated by FERC or not at all.

The FPA and this Court's precedent provide FERC with the authority to regulate effectively. The FPA provides that electric energy "shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof . . . ." *See* FPA § 201(c), 16 U.S.C. § 824(c). The Court has interpreted this definition to include

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[19] *See supra* pp. 5-6.

any transmission of electric energy over a high voltage transmission line connected to an interstate transmission grid. *See FPC v. Florida Power & Light*, 404 U.S. 453 (1972) (*FP&L*). To determine whether a transmission of electric energy is in interstate commerce as defined in section 201(c), the Court has said it will look to "an engineering and scientific, rather than a legalistic or governmental, test." *See id.* at 454 (quoting *Connecticut Light & Power Co. v. FPC*, 324 U.S. 515, 529 (1945)) (internal quotations omitted). The determination has never turned on an accounting or invoicing procedure (e.g., bundling) or on the contractual relationship between the supplier and customer, but on a scientific understanding of transmission.

In *FP&L*, this Court, addressing the science, focused on the point of interconnection, the "bus" between facilities connected to an interstate grid. The Court accepted FERC's finding that even though the electric utility's own generation facilities were located in the same state as its customer, because of interconnections electric energy necessarily crossed the state line at the bus. *See id.* at 461-63. Because some electricity generated in a state is necessarily consumed in other connected states, and some electricity consumed in a state is necessarily supplied by generation facilities in other connected states, the Court held that transmissions over the interconnected grid are in interstate commerce. *See id.*; *Florida Power & Light*, 37 F.P.C. 544, 550 (1967) ("there is a commingling of energy from different sources at a bus with the result that energy which flows away from such bus is so fully commingled as to consist of energy which has entered the bus both from interstate and intrastate sources"). As Justice Douglas noted in his dissent in *FP&L*, the decision meant that "every privately owned interconnected

[transmission] facility in the United States . . . is within the FPC's jurisdiction." 404 U.S. at 471.[20]

Although the Court spoke in *FP&L* of electrons crossing state lines, the "engineering and scientific" truth is much broader. Every use of electric energy by a connected user is served by all generators connected to the grid, not by a specific generation source. When facilities are interconnected, electric energy does not travel on a closed path from a particular generator to a specific distribution point. On the contrary, electric energy from all generators connected to the grid forms a pool of energy that services all load requirements throughout the grid. If a utility's generation facility is connected to the grid, its output cannot be segregated for use to serve in-state or any other specific load. "All of the electric energy produced by all the generating units [on an interconnected system] is delivered to the common coordinated and integrated modern transmission

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[20] The legislative history of the FPA contains explanations to Congress of the precise point that Justice Douglas explained (and against which he protested in dissent) in *FP&L*: that interconnection was sufficient to create interstate transmission. For example, a study prepared by Yale Law School Professor Richard Joyce Smith and presented at the 1935 hearings stated:

> In the absence of far-flung technological tie-ups and financial ententes, electric utilities undoubtedly are in fact local enterprises and the regulatory machinery of the individual State, through periodic revisions, may have been adequate to cope with their activities. But once the industry begins to transcend State boundaries either *by physical interconnections* or by subtle business and financial affiliations the theory of State regulation may become obsolete. . . . Decisions as to the power of the Federal Government to regulate interstate light and power business thus far have assumed that the determinant of interstate business is *physical interconnection* with actual transmission across State boundaries.

Hearings on H.R. 5423, at 77, 97 (emphasis added).

system from which all of the customers are supplied." *Florida Power & Light*, 37 F.P.C. at 566. Viewed differently, "[t]here is no way to determine what path electricity actually takes between two points or indeed whether the electricity at the point of delivery was ever at the point of origin." *See Northern States Power Co. v. FERC*, 30 F.3d 177, 179 (D.C. Cir. 1994).

For the grid to operate, its facilities must be electromagnetically synchronized; that is, all generators must be operated so that they rotate at 60 cycles per second (or a multiple thereof). This "synchronism" is maintained by a combination of automatic and human-controlled measures that respond to changes in both demand and supply. Every use physically affects the entire system, drawing on all sources and, to some degree, employing all of the interstate grid to transmit the power being used. "'[I]f a housewife in Atlanta on the Georgia system turns on a light, every generator on Florida's system almost instantaneously is caused to produce some quantity of additional electric energy which serves to maintain the balance in the interconnected system between generation and load.'" *FP&L*, 404 U.S. at 460 (quoting 37 F.P.C. at 567-68). Similarly, a transmission line that is downed (or taken off line by its owner) in Florida affects the flow of power to users in every state in the Eastern Interconnection. *See* 37 F.P.C. at 567-68.

State regulation clearly could not eliminate the undue discrimination FERC found. First, as a physical matter, since uses of the grids cannot be separated into discrete transmissions from generators to distribution points, each grid must be regulated as an interstate whole. Second, since competing generation facilities, competing suppliers, and different users are located in different states, and transmissions between them involve and affect facilities used by all of them, no state could constitutionally regulate the

terms that give rise to undue discrimination. *See LP&L*, 406 U.S. at 632-33.[21] Third, even to the extent the states could constitutionally promulgate regulations, the inevitable effect of their attempt would be varied and conflicting regulatory programs reflecting the competing interests of different states and their suppliers and users. *See id.* at 632-34 (state regulation of interstate transportation for "direct" sales of gas would "produce a seriously inequitable system" created by an "unavoidable conflict between producing States and consuming States" and the States' incentive to regulate in the "State, not the national interest."); *see also Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 377 (1983) ("[T]ransmission of energy is an activity particularly likely to affect more than one State, and its effect on interstate commerce is often significant enough that uncontrolled regulation by the States can patently interfere with broader national interests.").

FERC cannot disclaim its statutory authority to regulate all interstate transmissions. "[W]hen [the court] is presented with an attempt by the federal authority to control a problem that is not, by its very nature, one which state regulatory commissions can be expected to deal, the conclusion is irresistible that Congress desired regulation by federal authority rather than nonregulation." *LP&L*, 406 U.S. at 641 (quoting *FPC v. Transcon. Gas Pipe Line Corp.*, 365 U.S. 1, 28 (1961)) (internal quotations omitted). The very reason Congress adopted the FPA was to give the FPC jurisdiction over areas beyond the states' constitutional and practical reach. *See Arkansas Elec.*, 461 U.S. at 384 ("nothing in the language, history, or policy of the Federal Power Act

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[21] *See Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927); *see also Healy v. The Beer Inst.*, 491 U.S. 324, 336 (1989) ("The critical [constitutional] inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State.").

suggests" that Congress intended to leave an aspect of the industry "unregulated. . . . Congress's purpose in 1935 was to fill a regulatory gap, not to perpetuate one"); S. Rep. No. 74-621, at 17 (noting, in discussing the purpose of the legislation, that both the "regulatory gap" created by *Attleboro* as well as "[o]ther features of this interstate utility business are equally immune from State control either legally or practically"). FERC's denial of its statutory authority threatens Congress's objectives of non-discriminatory, free, and open competition among suppliers and a cheap and reliable supply of power to users in every part of the Nation.

II. BY REFUSING TO EXTEND OPEN ACCESS TO BUNDLED RETAIL TRANSMISSIONS, FERC VIOLATED ITS OBLIGATION UNDER THE FEDERAL POWER ACT TO CORRECT THE PERVASIVE DISCRIMINATION IT FOUND.

As FERC acknowledged in the orders under review, "it is our statutory *obligation* under sections 205 and 206 of the Federal Power Act to remedy undue discrimination," and "[t]o do so, we must eliminate the remaining patchwork of closed and open jurisdictional transmission systems and ensure that *all* these systems . . . cannot use monopoly power over transmission to unduly discriminate against others." Order No. 888 at 31,635, Pet. App. 133a (emphasis added). Moreover, FERC itself held that "[t]he *only* way to effectuate competitive markets and remedy discrimination is through readily available, non-discriminatory transmission access." Order No. 888-A at 30,176, Pet. App. 382a (emphasis added). Yet the final rule FERC adopted exempts transmission included in bundled retail sales from any open access requirements at all.

Where Congress commands an agency to adopt a remedy for all discrimination that it finds, as it did in section 206 of the FPA, 16 U.S.C. § 824e(a), the agency is denied discretion; it may not address only a small fraction of the

problem and then fold its tent. FERC's suggestion in Order No. 888 (abandoned by FERC on rehearing) that open access is not "necessary" for bundled retail transmission was both unsupported and wrong. And FERC's refusal of jurisdiction over the 60% of relevant interstate transmission that is billed as a bundled retail charge is based on a misreading of the FPA.

A. FERC's Decision Not To Remedy the Discrimination It Found in Sixty Percent of Pertinent Transmissions Violates Sections 205 and 206 of the Federal Power Act.

As FERC itself recognized in the orders under review, the Federal Power Act "'fairly bristles' with concern for undue discrimination." Order No. 888 at 31,669, Pet. App. 181a-182a (quoting *Associated Gas Distribs. v. FERC*, 824 F.2d 981, 998 (D.C. Cir. 1987)). Section 205(b) of the FPA forbids any public utility subject to FERC's jurisdiction from "mak[ing] or grant[ing] any undue preference or advantage to any person or subject[ing] any person to any undue prejudice or disadvantage." 16 U.S.C. § 824d(b). If FERC finds such discrimination, section 206(a) of the FPA commands FERC to remedy it:

> Whenever the Commission . . . shall find that any rate, charge, or classification demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission *shall* determine the just and reasonable rate, charge, classification, . . . practice, or contract to be thereafter observed and in force, and *shall* fix the same by order.

Id. § 824e(a) (emphasis added).

Section 206 is mandatory. Congress directed that FERC "shall" determine and fix a remedy, not that it "may" do so. An agency is required to follow such directives. *See, e.g.*, *Escoe v. Zerbst*, 295 U.S. 490, 493 (1935) ("'shall' . . . is the language of command").[22] This Court has recognized that sections 205 and 206 of the FPA are "directives," not guidelines. *Gulf States Utils. Co. v. FPC*, 411 U.S. 747, 759 (1973). Under section 206, "the Commission has the duty—not the option" to remedy whatever unjust, unreasonable, and discriminatory practices it finds. *Louisiana Pub. Serv. Comm'n v. FERC*, 184 F.3d 892, 897 (D.C. Cir. 1999). Indeed, FERC itself has always understood section 206 as a command, not a suggestion. Both the orders under review,[23] and other FERC orders,[24] acknowledge repeatedly that FERC

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[22] *See also McLaurin v. Prater*, 30 F.3d 982, 984 (8th Cir. 1994) ("the word 'shall' . . . is a mandatory command . . . . '[S]hall' does not mean 'may' or 'is permitted to'; 'shall' has been consistently understood to mean that something is required."); *Ass'n of American Railroads v. Costle*, 562 F.2d 1310, 1312 (D.C. Cir. 1977) (where a statute directs that an agency "shall" regulate, it must do so, because "[t]he word 'shall' is the language of command in a statute").

[23] *See, e.g.*, Order No. 888 at 31,635, Pet. App. 133a ("[I]t is our statutory *obligation* under sections 205 and 206 of the Federal Power Act (FPA) to remedy undue discrimination.") (emphasis added); *id.* at 31,669, Pet. App. 182a-183a (describing the FPA's antidiscrimination "mandates" and concluding that "we have ample legal authority—indeed, a responsibility—under section 206 of the FPA to order the filing of non-discriminatory open access transmission tariffs if we find such order necessary as a remedy for undue discrimination"); *id.* at 31,676, Pet. App. 198a-199a ("Sections 205 and 206 of the FPA *mandate* that we ensure that, with respect to any transmission in interstate commerce . . . no person is subject to any undue prejudice or disadvantage.") (emphasis added); *id.* at 31,682, Pet. App. 214a ("it is our *duty* to eradicate unduly discriminatory practices") (emphasis added).

[24] *See Southern Co. Servs., Inc.*, 83 F.E.R.C. ¶ 61,079, at 61,383, 61,386-87 (1998) (quoting Order No. 888); *Pacific Gas & Elec. Co.*, 77 F.E.R.C. ¶ 61,204, at 61,793, 61,819 (1996) (under section 206 FERC has the "obligation" to remedy undue discrimination); *Middle S. Energy, Inc.*,

has a statutory duty to remedy all undue discrimination it finds.

In the orders under review, FERC expressly found the kind of undue discrimination that Congress directed the agency to remedy. FERC specifically found that vertically integrated utilities regularly discriminate by providing themselves and their affiliates transmission superior to the transmission they provide to competing power suppliers. The orders document outright refusals to transmit and delaying tactics used by transmission owners to block competing suppliers from delivering electric energy to customers, as well as inferior service and inferior terms imposed by utilities on competing suppliers who lack transmission alternatives. *See* Order No. 888 at 31,683, 31,926, Pet. App. 215a-216a, 315a-331a. FERC also clearly found that this discrimination will continue unless FERC acts to stop it:

> We conclude that unduly discriminatory and anticompetitive practices exist today in the electric industry and, more importantly, that such practices will increase as competitive pressures continue to grow in the industry, unless the Commission acts now to prevent such practices. . . . The inherent characteristics of monopolists make it inevitable that they will act in their own self-interest to the detriment of others by refusing transmission and/or providing inferior transmission to competitors in the bulk power markets to favor their own generation, and it is our duty to eradicate unduly discriminatory practices.

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26 F.E.R.C. ¶ 63,044, at 65,093, 65,113-14 (1984) (section 206 "mandates that the Commission must revise the terms of [contracts among utilities] to eliminate undue preferences or discrimination").

Id. at 31,682, Pet. App. 213a-214a. FERC reaffirmed these findings on rehearing:

> [T]he vast majority of utilities historically have declined to transport electric energy that would compete with their own sales or have offered access that is inferior to what they use for their own sales. . . . [D]iscrimination in transmission services, when viewed in light of utilities' own uses of their transmission systems compared to what they offer third parties, has denied and will continue to deny customers access to electricity at the lowest reasonable rates. The entities on rehearing have raised nothing to persuade us that it is in the interests of consumers to maintain the self-evident incentives for transmission owners to exercise their monopoly power over transmission to discriminate in favor of their own generation sales—incentives that will only increase in the future as competitive pressures continue to escalate.

Order No. 888-A at 30,210, Pet. App. 436a-437a.[25] In making these findings, FERC did not distinguish between bundled and unbundled transmission or suggest that transmission owners' incentives to discriminate depend in any way on how the cost of transmission is accounted for and invoiced at retail.

Notwithstanding these clear findings of pervasive discrimination and Congress's instruction to remedy all undue discrimination it finds, FERC took aim at only a small

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[25] FERC also noted that this sort of discrimination against independent power suppliers was a subject of particular congressional concern. *See id.* at 30,176, Pet. App. 382a (finding that discrimination, "if permitted to continue, will smother the fledgling competition in electricity markets and undermine the national policies reflected in the Energy Policy Act of 1992 to encourage the development of competitive markets").

slice of the problem and declared victory. Despite finding that the "only way to effectuate competitive markets and remedy discrimination is through readily available, non-discriminatory transmission access," *id.* at 30,176, Pet. App. 382a, FERC refused to extend open access to transmission bundled at the retail level—leaving about 60% of all relevant transmission beyond the reach of the "only" effective remedy. Moreover, FERC's purported solution even for unbundled sales is illusory: unless a state regulator makes retail unbundling mandatory, a vertically integrated utility may opt in or out of open access simply by changing the way it bills its retail customers. An antidiscrimination rule that permits the discriminators to decide whether the rule applies is no rule at all. *See Mississippi River Transmission Corp. v. FERC*, 969 F.2d 1215, 1219 (D.C. Cir. 1992) (observing that interpreting the NGA not to grant FERC jurisdiction over bundled retail transportation of natural gas would "be tantamount to conferring on private parties the right to decide whether FERC could set the rate for interstate transportation. Private parties would have this power because it would be entirely up to them whether to structure a direct sale and interstate-transportation transaction in terms of a bundled price or separate charges").

Where Congress orders an agency to remedy an identified problem, Congress intends the agency to remedy *all* of the problem. *See, e.g., Ass'n of American Railroads v. Costle*, 562 F.2d 1310 (D.C. Cir. 1977) (where Congress directed EPA to promulgate noise emission standards for railroad "equipment and facilities," EPA's regulation of only some "equipment and facilities" did not satisfy its obligation, and the agency was required to regulate further until its obligation was fulfilled). By refusing to adopt any remedy at all for discrimination in transmissions bundled with retail sales, FERC violated section 206 of the FPA.

B. FERC's Excuses for Declining To Address Discrimination in Transmissions for Bundled Retail Sales Are Not Valid.

FERC's attempts to justify its refusal to apply its remedy to interstate transmission for bundled retail sales are unsupported by the record and remarkably terse. A single paragraph in Order No. 888 states, without any explanation or record support, that "[a]lthough the unbundling of retail transmission and generation . . . would be helpful in achieving comparability, we do not believe it is necessary"; in addition, FERC said such unbundling "raises numerous difficult jurisdictional issues" that it did not further discuss. Order No. 888 at 31,699, Pet. App. 235a. On rehearing, in Order No. 888-A, FERC abandoned its earlier "not . . . necessary" remark, deciding instead that it does not have jurisdiction over the interstate transmission component of bundled retail sales. *See* Pet. App. 454a-456a. Neither excuse justifies FERC's failure to carry out the antidiscrimination command of section 206.

1. FERC's Initial Suggestion That Full Open Access Is Not "Necessary" To Eliminate Undue Discrimination Is Unsupported and Does Not Excuse FERC's Failure To Carry Out the FPA's Command.

In Order No. 888, FERC declined to apply the OATT to transmissions for bundled retail sales, stating without explanation that although full open access would be "helpful" to eliminate undue discrimination, it was "not . . . necessary." Pet. App. 235a. FERC did not assert, or offer any evidence, that the problem of undue discrimination in interstate transmission is any less pervasive or less important with respect to transmissions that are sold at retail at a bundled price, nor did it find that discrimination in this segment could be cured by any means other than open access. FERC's carveout thus violated the basic principles of administrative

law that an agency must explain its actions and must base its factual findings on substantial evidence. *See Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 48, 52 (1983) ("an agency must cogently explain why it has exercised its discretion in a given manner"; there must be a "rational connection between the facts found and the choice made") (internal quotation omitted).[26] In this case, not only is FERC's "not . . . necessary" suggestion unsupported by the substantial evidence required by the FPA, *see* 16 U.S.C. § 825*l*, it wholly contradicts the facts that the agency did find.

The orders under review reflect a record establishing that the vertically integrated utilities' monopoly control over the interstate transmission grid has been "the single greatest impediment" to competition in bulk power marketing, NOPR at 33,049, Pet. App. 558a, and that the discriminatory behavior of these utilities threatens to "smother the fledgling competition in electricity markets and undermine the national policies reflected in the Energy Policy Act of 1992 to encourage the development of competitive markets." Order No. 888-A at 30,176, Pet. App. 387a. FERC documented

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[26] This Court and others have often rejected such conclusory agency pronouncements. *See, e.g., Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 167-68 (1962) (reversing agency action because of the agency's failure to explain election between two remedies: "There are no findings and no analysis here to justify the choice made, no indication of the basis on which the Commission exercised its expert discretion"); *United States Telecom Ass'n v. FCC*, 227 F.3d 450 (D.C. Cir. 2000) (vacating FCC order that did not explain its use of key statutory terms or the basis for its conclusions); *see also Rocky Mountain Helicopters, Inc. v. FAA*, 971 F.2d 544, 547-48 (10th Cir. 1992) (vacating conclusory agency finding as not supported by substantial evidence); *Schurz Communications, Inc. v. FCC*, 982 F.2d 1043 (7th Cir. 1992) (vacating FCC order where agency failed adequately to explain key findings); *City of Kansas City, Missouri v. Dep't of Hous. & Urban Dev.*, 923 F.2d 188, 194 (D.C. Cir. 1991) (finding arbitrary and capricious agency action based on a factual premise contradicted by the agency's record).

example after example of discriminatory conduct: outright refusals to transmit, delay tactics, and inferior terms of service. *See* Order No. 888 at 31,683, 31,919-26, Pet. App. 215a-216a, 315a-331a. And FERC concluded that nothing short of open access was sufficient to remedy this pervasive undue discrimination. *See* Order No. 888-A at 30,176, Pet. App. 382a.

None of these findings distinguishes between transmissions for bundled sales and unbundled sales, and there is no reason to expect any such distinction. A vertically integrated utility has the same control over the transmission facilities that competitors need, and the same ability to discriminate, regardless of how the utility accounts for and bills for its services at retail. For that reason, FERC described the need for open access broadly, suggesting that "all" transmission facilities must move to open access to avoid "benefit[ing] some customers at the expense of others." Order No. 888 at 31,635, Pet. App. 133a; *see also* NOPR at 33,071, Pet. App. 611a ("Unless all public utilities are required to provide non-discriminatory open access transmission, the ability to achieve full wholesale power competition, and resulting consumer benefits, will be jeopardized."). Indeed, in its Notice of Proposed Rulemaking, FERC recognized that limiting open access to unbundled transmission "raises the possibility that the quality of transmission service for retail purposes will be superior to the quality of transmission service offered for wholesale purposes," Pet. App. 634a, but the agency never returned to this concern at any point in its proceedings.

Exempting transmissions for bundled retail sales allows the vertically integrated utilities pervasive unfair advantages in supplying and purchasing electricity. For example:

(a) A utility can reserve superior transmission capacity for its own bundled retail sales, at times even closing its facilities to other transmissions. *See* Order No. 888 at 31,919-26, Pet. App. 315a-331a. Doing so distorts

competition, forcing competitors of the utility to scramble for less direct, less predictable and more expensive transmission options, assuming that any transmission options are available at all. *See* Narashima Rao & Richard D. Tabors, *Transmission Markets: Stretching the Rules for Profit and Fun*, 13 Elec. J. 20, 27 (2000).

(b) The exemption enables the transmission-owning utility to preclude competition for those customers (e.g., computer server farms or hospitals) that need very high levels of service reliability, because utilities are effectively free to impose curtailment plans allowing them to favor their own bundled retail sales under conditions of system constraint.[27]

(c) In addition to anti-competitive behavior by utilities, some states have threatened, in response to predictions of energy shortage, to close "their" portions of the interstate grid to transmissions other than for the in-state utilities that provide electricity to their citizens, attempting in this way to reserve "their" electricity to themselves. *See, e.g., Davis Wants State Government to Play Larger Role in Resolving Utility Crisis*, The Wall Street Journal, Jan. 9, 2001, at A3.

(d) The discrimination resulting from exempting transmissions for bundled retail sales also extends to access to vitally important information about the scheduling and

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[27] In *Northern States Power*, FERC took the position that even though it did not believe it had jurisdiction over interstate transmissions for bundled retail sales, it could bar transmission-owning utilities from discriminating in favor of such transmissions and against the transmissions for wholesale or unbundled retail sales over which FERC concedes it has jurisdiction. The Eighth Circuit rejected this contention, 176 F.3d at 1095-96, and FERC did not seek this Court's review. Enron, which had intervened in the case, did petition for a writ of certiorari, but FERC and the utility largely resolved their differences in the particular case, and FERC opposed certiorari, which was denied. 528 U.S. 1182 (2000), No. 99-916.

status of the transmission system. The exemption effectively allows vertically integrated utilities exclusive access to important information about the use and availability of their facilities. *See Open Access Same-Time Information System (Formerly Real-Time Information Networks) and Standards of Conduct*, Order No. 889, [1991-1996 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 31,035, at 31,585, 31,585-90, 61 Fed. Reg. 21,737, 21,738-40 (1996). This gives them a competitive advantage in planning for and taking advantage of market conditions.

These examples demonstrate that without applying the OATT to all interstate transmissions, including the 60% of pertinent transmissions that are for bundled retail sales, *see supra* note 4, FERC cannot eliminate the undue discrimination it found. In other words, FERC's "not . . . necessary" finding was unsupported and wrong, and cannot excuse FERC's failure to satisfy its mandate under section 206.

2. *The D.C. Circuit Erred in Sustaining FERC's Jurisdictional Defense of Its Failure To Eliminate the Undue Discrimination That It Found.*

On rehearing, in Order No. 888-A, FERC justified its failure to eliminate undue discrimination involving transmissions for bundled retail sales by asserting that it lacks "jurisdiction" over such transmissions. Pet. App. 453a-456a. On petition for review, the D.C. Circuit sustained FERC's declination solely on the jurisdictional ground. The court ruled that FERC's categorization of interstate transmission for bundled retail sales as part of the retail sale, rather than as interstate transmission, was a "permissible policy choice."

This was error. As Enron showed in Part I, no "choice" was needed or called for. FERC's action simply ignores the plain meaning of the statute. An interstate transmission does

not change character, or cease to be within FERC's jurisdiction under the language of the statute, merely because its cost is bundled as an accounting and invoicing matter with the charge for energy and/or delivery in a retail sale. Moreover, there is no reason why FERC cannot or should not regulate the terms of such interstate transmissions, just as it regulates the terms of wholesale transmissions. In either case, the FERC-regulated terms eventually become a component of a state-regulated retail sale, but this means only that states, in accordance with long-established principles, must take FERC's determinations as to matters within its jurisdiction into account when they regulate retail sales.

The most important point is that *only* FERC can eliminate the undue discrimination FERC found in the provision of interstate transmission services. Individual states cannot do this in their regulation of retail sales. Only FERC can require the owners of interstate transmission facilities to serve others on terms as favorable as the terms on which they serve themselves. Only FERC can regulate the operation of the interstate grid in a way that assures open and fair competition, leading to the provision of electricity with the greatest possible reliability at the lowest possible cost in every region. FERC's erroneous interpretation of the statute prevents it from doing so.

CONCLUSION

The decision of the court of appeals sustaining FERC's abdication of jurisdiction over interstate electric transmission for bundled retail sales should be reversed.

Respectfully submitted,

JEFFREY D. WATKISS
BRACEWELL & PATTERSON, L.L.P.
2000 K Street, N.W.
Suite 500
Washington, D.C. 20006
(202) 828-5800

JOSEPH R. HARTSOE
SARAH NOVOSEL
ENRON CORPORATION
1775 I Street, N.W.
Washington, D.C. 20006
(202) 828-3360

LOUIS R. COHEN
Counsel of Record
JOSEPH E. KILLORY, JR.
JONATHAN J. FRANKEL
IJAY PALANSKY
MICHAEL PLOTNICK
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, D.C. 20037-1420
(202) 663-6000

Counsel for Petitioner Enron Power Marketing, Inc.

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IN THE

Supreme Court of the United States

ENRON POWER MARKETING, INC.,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

CORRECTED COPY

STATE OF NEW YORK, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

BRIEF ON THE MERITS OF RESPONDENTS THE ELECTRICITY CONSUMERS RESOURCE COUNCIL, *ET AL.*

SARA D. SCHOTLAND
CLEARY, GOTTLIEB,
STEEN & HAMILTON
2000 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
202-974-1500

Counsel for The Electricity Consumers Resource Council, et al.

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27 pp

QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission (FERC), which has jurisdiction over interstate transmission of electricity, is obliged to regulate such transmission for sales to retail customers on a bundled basis to remedy undue discrimination and to promote reliability of the interstate grid.

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IN THE

Supreme Court of the United States

ENRON POWER MARKETING, INC.,

Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,

Respondents.

STATE OF NEW YORK, *et al.*,

Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,

Respondents.

BRIEF ON THE MERITS OF RESPONDENT INDUSTRIAL CONSUMERS (THE ELECTRICITY CONSUMERS RESOURCE COUNCIL, AMERICAN IRON AND STEEL INSTITUTE, AND AMERICAN CHEMISTRY COUNCIL)

OPINION BELOW

The opinion of the United States Court of Appeals for the District of Columbia Circuit is reported at 225 F.3d 667 (D.C. Cir. 2000), and reprinted at Petitioner's Appendix (Pet. App.) 3a to 121a. Federal Energy Regulatory Commission Order No. 888 is reported at F.E.R.C. Stats. & Regs. ¶ 31,036, 61 Fed. Reg. 21, 540 (1996). FERC's rehearing decisions, Order No. 888-A and Order No. 888-B, are reported respectively at III F.E.R.C. Stats. & Regs. ¶ 31,048, 62 Fed. Reg. 12,274 (1997), and 81 F.E.R.C. ¶ 61,248, 62 Fed. Reg. 64,688 (1997). Relevant portions of FERC Orders Nos. 888 and 888-A and FERC's Notice of Proposed Rulemaking, F.E.R.C. Stats. & Regs. ¶ 32,514, 60 Fed. Reg. 17,662 (1995), are reprinted at Pet. App. 125a to 654a.

JURISDICTION

The court of appeals entered its judgment on June 30, 2000, and issued its order denying a timely-filed motion for rehearing on August 22, 2000. This Court has jurisdiction under 28 U.S.C. § 1254(l).

STATUTES AND REGULATIONS INVOLVED

Sections 201, 205, 206, 211, 212, 213, and 313 of the Federal Power Act (FPA), 16 U.S.C. §§ 824, 824d, 824e, 824j, 824k, 824l and 825l, are reprinted in the Appendix at Pet. App. 652a to 681a.

Sections 1, 4, and 5 of the Natural Gas Act (NGA), 15 U.S.C. §§ 717, 717c, and 717d, are reprinted in the Appendix at Pet. App. 645a to 651a.

Relevant portions of FERC Orders Nos. 888 and 888-A are reprinted in the Appendix at Pet. App. 125a to 551a.

STATEMENT

FERC has found that vertically-integrated electric utilities have an incentive to deny use of the transmission wires that are an essential facility to deliver power to markets by providing transmission service to their own customers to the detriment of competing suppliers. In FERC Order No. 888, FERC found that transmission-owning utilities have an inherent incentive to discriminate, and have discriminated, against competing suppliers that are dependent on the utilities for transmission services. Pet. App. 213a-216a, 315a-331a. Based on this finding, FERC required utilities to file an "open access transmission tariff" (OATT) and to take transmission services for their own wholesale sales under the OATT pursuant to the same terms and conditions they offer to other users. Pet. App. 178a.[1] But FERC declined to apply this requirement to a utility's transmission services when the charge for power transmitted and distributed to retail customers is a single "bundled" charge that includes both the price of power and transmission. By declining to apply the OATT to transmission for bundled retail sales, FERC has failed to deal with the majority of transmissions that are the source of undue discrimination that FERC itself has found. Almost 60 percent of retail sales by investor-owned utilities and

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[1] FERC applied this same requirement to unbundled retail sales, i.e., retail transactions in which the utility, either voluntarily or under compulsion at requirement of state law, states separate charges for the electric energy and for the service of transmitting the energy. Pet. App. 306a.

independent power producers are bundled.[2] Thus, FERC left the IOUs free to ignore the OATT, and discriminate in favor of their own retail customers, with respect to a very high percentage of the use of their transmission facilities.

FERC claimed in Order No. 888-A that it lacks jurisdiction to address discrimination in transmission associated with bundled retail sales. *See* Pet. App. 454a-456a. The court of appeals upheld FERC's discretion to determine that it lacked jurisdiction over interstate transmission for bundled retail sales.

A. Interest Of Industrial Consumers

The Electricity Consumers Resource Council (ELCON) is an association of industrial consumers of electricity organized to promote the development of

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[2] In 1999, approximately 2.44 billion megawatt hours of electricity were sold at retail by FERC jurisdictional generators: 2.4 billion by investor-owned utilities (IOUs) plus 43 million by independent power producers (IPPs). *See* Energy Information Administration, United States Department of Energy (EIA), Financial Statistics of Major U.S. Publicly Owned Electric Utilities 1999, at 3 (2000); EIA, Electric Power Annual 1999, Vol. 2, at 87 (2000). At most, 915 million of these megawatt hours, or 37.5%, had previously been sold at wholesale. *Id.* (showing 545 million megawatt hours were available for resale by IOUs and 370 million megawatt hours were sold "to Utilities" by IPPs). About 76 million megawatt hours (3% of retail sales) were sold on an unbundled basis, with the remaining 97% sold on a bundled basis. *See* EIA, Electric Sales and Revenue 1999 at 3 (2000) (noting that total retail sales were generally made on a bundled basis); Electric Sales and Revenue 1999, at 245, 255 (2000) (showing transmissions of 76 million megawatt hours sold pursuant to "retail wheeling" programs, i.e., on an unbundled basis). In total, therefore, almost 60% (1.45 billion of 2.44 billion megawatt hours) of pertinent transmissions were bundled with retail sales.

coordinated and rational federal and state policies that will assure an adequate, reliable and efficient electricity supply for all users at competitive rates and prices. ELCON member companies produce a wide range of products, including: steel, aluminum, chemicals, petroleum, motor vehicles, industrial gases, machinery, glass, agricultural and food products, rubber, computer chips, paper and electronics. The member companies of ELCON consume approximately 5 percent of all electricity in the United States.

The American Iron and Steel Institute (AISI) is the principal trade association of the North American steel industry. Its member companies account for about 70 percent of the raw steel production in the United States. The steel industry is one of the most energy-intensive sectors in the United States; the cost of electricity for AISI members may constitute as much as 20 percent of the manufacturing cost of a steel mill product.

The American Chemistry Council (ACC) is a nonprofit trade association whose member companies represent more than ninety percent of the productive capacity of basic industrial chemicals in the United States. The manufacturing processes of many ACC member companies are highly energy-intensive. In addition, the chemical industry uses a substantial amount of self-generated electricity. Total electricity used by the industry, purchased plus self-generated, represents approximately 18 percent of industrial electricity consumption in the United States and approximately 6 percent of national electricity consumption.

Industrial Consumers are vitally concerned to have access to power supplies that are both reliable and low-cost. Recent events in California and other sections of the

country show the absolute urgency of maximizing the efficiency and reliability of the interstate grid. With respect to reliability, interruption in power supplies can have significant economic consequences. In the case of some industries, even momentary interruptions can yield losses of hundreds of thousands of dollars.

The cost of power represents an equally important consideration. Industrial Consumers must be able to enjoy the benefit of competition among available suppliers in electricity as with respect to other commodities and raw materials in order to be able to compete in international markets. It is essential to Industrial Consumers' own ability to compete that FERC eliminate discriminatory access to transmission facilities. Ending such discrimination is an essential condition to the development of competitive markets. Industrial Consumers, Enron, and other parties have long advocated that FERC conduct a rulemaking to assure that transmission providers are required to provide service to retail "native load" customers under the Order No. 888 OATT.[3] Discrimination will persist in the electric power industry until all transmission service, wholesale and retail, is subject to the same tariff. FERC's parsimonious view of its statutory mandate has prevented it from acting to assure

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[3] On March 25, 1998, Enron, ELCON, and a coalition of power marketers and independent power producers filed a petition with FERC for a rulemaking that would require that all uses of the transmission service be subject to the OATT. The coalition asked FERC to unbundle transmission operationally from all merchant functions, including sales to captive native-loaded customers. *See* Petition for a Rulemaking on Electric Power Industry Structure and Commercial Practices and Motion to Clarify or Reconsider Certain Open-Access Commercial Practices, FERC Docket No. RM98-5-000 (1998). FERC never acted on the petition.

that all uses of the transmission grid are subject to the same set of rules.

B. Statutory Background

The FPA gives FERC jurisdiction over "the transmission of electric energy in interstate commerce" and "all facilities for such transmission." FPA § 201(b), 16 U.S.C. § 824(b). It also gives FERC jurisdiction over "the sale of electric energy at wholesale in interstate commerce." *Id.* Unlike its jurisdiction over the sale of electricity, FERC's jurisdiction over interstate "transmission" is not limited by the words "at wholesale." *See* Pet. App. 338a.

Section 205(b) of the FPA, 16 U.S.C. § 824d(b), bars any public utility, "with respect to any transmission or sale subject to the jurisdiction of the Commission," from "grant[ing] any undue preference or advantage to any person or subject[ing] any person to any undue prejudice or disadvantage" and requires each utility to file tariffs setting forth its "practices." Section 206(a), 16 U.S.C. § 824e(a), commands that if FERC determines that a practice is "unjust, unreasonable, unduly discriminatory or preferential," FERC must cure the discrimination and "determine the just and reasonable . . . practice . . . to be thereafter observed and in force, and shall fix the same by order."

C. Proceedings Below

In *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 681, 687 (D.C. Cir. 2000), Pet. App. 8a-9a, 20a-21a, the court of appeals considered, on the one hand, the claim by state groups that FERC had exceeded its jurisdictional reach in Order No. 888 and, on the other hand,

the claim by Petitioner Enron that FERC interpreted its jurisdiction too narrowly. The State of New York and other parties contended that FERC has no jurisdiction over interstate transmission for any retail sales, even unbundled sales. The D.C. Circuit rejected this contention, holding that the Act confers jurisdiction over unbundled interstate transmission of electric energy whether it is then sold at wholesale or retail. Pet. App. 34a-35a.

With respect to Petitioner Enron's opposite argument that FERC has jurisdiction over bundled retail sales, the court acknowledged that it was a plausible reading of the FPA to construe transmission "bundled with generation and delivery services and sold to a consumer for a single charge as . . . transmission services in interstate commerce" within FERC's jurisdiction. Pet. App. 35a. [4] However, the court ruled that FERC's decision to decline jurisdiction over interstate transmission of electric energy for bundled retail sales was a "permissible policy choice" as to which FERC was entitled deference under *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984). Pet. App. 35a.

ARGUMENT

Section 201(b) of the FPA grants FERC jurisdiction over "the transmission of electric energy in interstate commerce and ... all facilities for such transmission." 16 U.S.C. § 824(b), Pet. App. 652a.[5] The

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[4] Industrial Consumers endorse the legal argument presented by Petitioner Enron Power Marketing, Inc., in its Petition for Certiorari.

[5] The transmission of "electric energy in interstate commerce" is defined in the FPA as electric energy "transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof; but

statute contains no limitation on the Commission's jurisdiction over interstate transmission: only "local distribution" is reserved to the states. *See id.* FERC's jurisdiction over interstate transmission is not limited to wholesale transactions. *See FPC v. Louisiana Power & Light Co.*, 406 U.S. 621, 636 (1972) (interpreting analogous provisions of the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717, *et seq.*).

FERC's exercise of its authority over all interstate transmission is needed to assure a single set of rules for the road to govern interstate transmission—the highways by which electric power is distributed to market. The reliability of the transmission grid will be jeopardized if there is balkanization of regulatory control over bundled retail transmission between FERC and each individual state. FERC jurisdiction over all interstate transmission is also essential to avoid discrimination by transmission-owning utilities. Unless discrimination is eliminated with respect to the great majority of transmission associated with bundled retail sales, competitive power markets cannot develop.

I. To Assure A Reliable Interstate Transmission Grid, FERC Must Exercise Authority Over Bundled Retail Transmission

FERC exercise of its jurisdiction over bundled retail transmission is necessary to ensure the growth of competition in interstate power markets, and to prevent balkanization of the transmission grid. Federal jurisdiction over bundled retail transmission need not intrude on

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only insofar as such transmission takes place within the United States." 16 U.S.C. § 824(c), Pet. App. 653a.

appropriate areas of state regulation such as retail price regulation, certificating generation or local siting authority or the decision whether to adopt restructuring laws which may require utilities to divest generation or to institute retail customer choice. However, FERC exercise of its jurisdiction over transmission will allow consistency in determination of available transmission capacity, in congestion management, and in ascertaining the conditions under which transmission will be interrupted or curtailed.

A regime under which each state can set its own rules for operating the transmission system used to make bundled retail sales within that state is counterproductive to rational and coherent transmission regulation. The absence of a single regulator enables one state to favor transmission to its own residents, at the expense of its neighbors and at the expense of power destined for wholesale or unbundled retail transactions. The pernicious impact of allowing parochial and inconsistent administration of the interstate grid is intuitive and easily illustrated. In a time of congestion on an interstate highway, surely it would be intolerable for the state troopers of a given state to favor their own residents and require motorists with out-of-state license plates to exit the highway.[6] If anything, the consequences of chauvinistic state action are even more dire in electricity, as power does not flow simply from point to point but follows the path of least resistance. There are no side roads; power cannot be stored; and power inevitably

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[6] *The Electricity Competition and Reliability Act: Hearing on H.R. 2944 Before the House Subcommittee on Energy and Power of the House Committee on Commerce*, 106th Cong. 77-79 (1999) (statement of FERC Commissioner William Massey).

moves through interstate transmission wires in an interconnected interstate grid.

The existing patchwork of inconsistent and outdated jurisdictional rules for this essential interstate delivery system, coupled with splintered network management, create obstacles and uncertainties that prevent development of a competitive market for electric power. If buyers and sellers lack confidence that electric power will be delivered reliably and on reasonable terms and conditions, they will not transact business.[7]

FERC Commissioner William Massey explained in testimony before the Senate Committee on Energy and Natural Resources:

> Electric power markets are inherently interstate in nature. The laws of physics, and hence power markets, do not respect state boundaries. In order to thrive, such markets must have an open, non-discriminatory, well-managed, and efficiently priced interstate transmission service that links buyers and sellers of power.

Electricity Deregulation: Hearing Before the Senate Committee on Energy and Natural Resources, 106th Cong. 183-88 (2000). Former FERC Chairman James Hoecker has similarly expressed concern that "divide[d] authority over reliability measures among states and between the states,

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[7] Br. for the State Public Service Commissions In Opp'n, Jan. 26, 2001.

FERC and the industry threatens efficiency and indeed even reliability itself."[8]

FERC's failure to exercise its jurisdiction over bundled retail transmission threatens the orderly administration of the transmission grid and jeopardizes reliability of transmission service for all consumers.

II. Unless FERC Exercises Jurisdiction Over All Interstate Transmission, Including Bundled Retail Transmission, Discrimination Will Persist

A. FERC Has A Duty To Address Anticompetitive Practices That Fall Within Its Jurisdiction

In Order No. 888, FERC acknowledged that the FPA, like the NGA, "'fairly bristles' with concern for undue discrimination." Pet. App. 181a-182a, citing *Associated Gas Distribs. v. FERC*, 824 F.2d 981, 998 (D.C. Cir. 1987). *See also Gulf States Util. Co. v. FPC*, 411 U.S. 747, 758-59 (1973), *reh'g denied* 412 U.S. 944 (1973); *Alabama Power Co. v. FPC*, 511 F.2d 383 (D.C. Cir. 1974).

In *FPC v. Conway Corp.*, 426 U.S. 271 (1976), this Court considered whether the Federal Power Commission's (FPC's) authority, and responsibility, under §§ 205 and 206 of the FPA, extends to claims of discrimination between rates for two classes of service, only one of which is subject to the jurisdiction of the

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[8] "Reassessing Regulation in Light of Markets," Remarks of (former) Chairman James Hoecker, Mid-America Regulatory Commissioners Annual Meeting, June 12, 2000, at http://www.ferc.fed.us.

Commission. The FPC had determined that it could not address price squeeze claims. This Court rejected the FPC's position as "untenable." *Id.* at 277. The FPC has "jurisdiction to consider the allegations of the company's wholesale customers that the proposed wholesale rates, which are within the Commission's jurisdiction, are discriminatory and noncompetitive when considered in relation to the company's retail rates, which are not within the jurisdiction of the Commission." *Id.* at 272-73. The Court observed:

> The Commission thus cannot so easily satisfy its obligation to eliminate unreasonable discriminations or put aside its duty to consider whether a proposed rate will have anticompetitive effects. *The exercise by the Commission of powers otherwise within its jurisdiction "clearly carries with it the responsibility to consider, in appropriate circumstances, the anticompetitive effects of regulated aspects of interstate utility operations pursuant to . . . directives contained in §§ 205, 206. . . ."* *Gulf States Util. Co. v. FPC*, 411 U.S. 747, 758-759 (1973).

Id. at 278-279 (emphasis added).

In the case of electricity, as in natural gas, FERC has a statutory mandate to eliminate anticompetitive practices in interstate transmission.

B. FERC Cannot Address Discrimination In Transmission Without Exercising Jurisdiction Over Transmission Associated With Bundled Retail Sales

1. In The Order No. 888 Rulemaking, FERC Recognized The Potential For Discrimination Resulting From Excluding Bundled Retail Transmission From the OATT

FERC recognized in Order No. 888 that vertically-integrated utilities are motivated to discriminate in providing transmission access to their competitors:

> It is in the economic self-interest of transmission monopolists, particularly those with high-cost generation assets, to deny transmission or to offer transmission on a basis that is inferior to that which they provide themselves. The inherent characteristics of monopolists make it inevitable that they will act in their own self-interest to the detriment of others by refusing transmission and/or providing inferior transmission to competitors in the bulk power markets to favor their own generation, and it is our duty to eradicate unduly discriminatory practices.

Pet. App. 213a-214a.

In the notice of proposed rulemaking, the Commission recognized that if bundled retail service were not made subject to the OATT, then utilities will provide service

> . . . under two separate arrangements – an explicit wholesale transmission tariff filed at the Commission and an implicit retail transmission tariff governed by a state regulatory body. It also raises the possibility that the quality of transmission service for retail purposes will be superior to the quality of transmission service offered for wholesale purposes.

Promoting Wholesale Competition through Open Access Non-Discriminatory Transmission Services by Public Utilities, Notice of Proposed Rulemaking, IV F.E.R.C. ¶ 32,514 at 33,081-82 (1995), Pet. App. 634a. FERC found that "unduly discriminatory and anticompetitive practices exist today in the electric industry." Order No. 888, Pet. App. 213a. *See also* Order No. 888-A, Pet. App. 382a. "[T]he vast majority of utilities historically have declined to transport electric energy that would compete with their own sales or have offered access that is inferior to what they use for their own sales." Order No. 888-A, Pet. App. 436a-437a. Structural conditions in the industry "make it inevitable" that transmission owners will "act in their own self-interest to the detriment of others by refusing transmission and/or providing inferior transmission to competitors." Order No. 888, Pet. App. 213a-214a.

Because FERC has jurisdiction over all interstate transmission, and because FERC has found that utilities have the motive and the opportunity to discriminate in transmission services, the court of appeals erred in deferring to FERC's determination not to exercise its jurisdiction to remedy the discrimination that it found with respect to the majority of transmission uses: those bundled with retail sales.

2. The Same Authority That The Commission Exercised Under The NGA To Extend Nondiscriminatory Open Access to Natural Gas Retail Customers Is Available Under the FPA

Following introduction of open-access pipeline transportation in Order No. 436, discrimination persisted and lack of service comparability plagued gas markets:

> [T]he firm transportation embedded within the *pipelines' bundled, city-gate, firm sales service is superior* to the pipeline's open-access firm transportation service. This means that pipelines and other gas suppliers are not competing on an even basis for sales customers, even where firm transportation is available to move the gas sold by the pipelines' competitors.

Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines after Wellhead Decontrol, Order No. 636, [1991-96 Regs. Preambles] F.E.R.C. Stats. & Regs. ¶ 30,939 at 30,402 (emphasis added). Not until FERC issued Order No. 636 and unbundled transportation completely from both the pipeline's wholesales and its direct retail sales was it able to achieve "an even basis for competition." *Id.*

Open access alone did not eliminate the incentives for pipelines to discriminate in favor of their own sales and against third-party shippers. Similarly, wholesale open-access electricity transmission does not establish comparability between the bundled transmission service that transmission-owning utilities use to serve their captive customers and the wholesale and unbundled retail transmission services that they provide to others. As Mr. Hoecker noted: "Recognizing the states' keen interest in ensuring that native load is not disadvantaged in the wholesale competition environment," FERC will "only be able to promote real competition to the extent that *all* uses of the grid and *all* transmission facilities are subject to the same non-discriminatory rules."[9]

With respect to the natural gas industry, FERC determined that in order to eliminate the incentive of a regulated transportation monopolist to discriminate in favor of its own and affiliated generation, it was necessary to make the merchant operation take transportation pursuant to rules identical to the rules that govern all other shippers. FERC's erroneous view of the parameters of its jurisdiction under the FPA is preventing the Commission from taking necessary

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[9] Remarks of James Hoecker, *supra* (emphasis in original).

steps to eliminate discrimination in the electric power industry.

In July 2000, FERC commissioned a staff report on the state of regional bulk power markets due to FERC's grave concern with poorly-functioning markets. FERC observed that it was incumbent on the Commission to take steps to investigate malfunctioning markets and serious price volatility. *See* Order Directing Staff Investigation, 92 FERC ¶ 61,160 (July 26, 2000).

On November 1, 2000, FERC issued its report, "Investigation of Bulk Power Markets – Midwest Region." FERC's Staff Report on the Midwest markets recommends that FERC:

> [r]educe the advantages of network service over point-to-point service by requiring that native load be served under the same tariff provisions as other transmission services. Given that all transactions serve load of one sort or another, all load would be treated in the same manner. This would eliminate the current incentives that vertically integrated transmission owners have to favor their native load through the manner and method of calculating ATC [available transmission capacity] and handling interconnection requests. It would also restore confidence among market participants that transmission owners were not calling TLRs [a form of

> service curtailment] to favor native load, because they would no longer have the incentive to do so.[10]

The Staff Report goes on to find:

> [M]any vertically integrated transmission owners may have incentives to resist efforts to make this information [on available transmission capacity] transparent and standardized, including information on the manner in which "native load" is handled in making these calculations. . . . As a consequence, the Commission may wish to eliminate the native load exemption and have all transactions under the same tariff. Given that all transactions serve load of one sort or another, all load would be treated in the same manner. This would provide all transmission owners the proper incentives to make relevant information available.[11]

In Order No. 888-A, FERC stated that "[t]he record supports our conclusion that absent open access, undue discrimination will continue to be a fact of life in today's and tomorrow's electric power markets." Pet. App. 382a. The record at the time of the Order No. 888 rule and

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[10] FERC, Staff Investigation of Bulk Power Markets: Midwest Region at 49 (Nov. 2000).

[11] *Id.* at 40.

the Agency's own reports since that date demonstrate that vertically integrated transmission-distribution utilities have a strong incentive to restrict the access of both wholesale and potential retail competitors to the transmission capacity that they control. Discrimination is ongoing and will persist until there is complete unbundling and consumers of all transmission services, wholesale and retail, take service pursuant to the same tariff at posted rates. FERC's unduly restrictive reading of its own jurisdiction prevents it from acting to remedy this discrimination.

CONCLUSION

The court of appeals' decision should be reversed.

Respectfully submitted,

Sara D. Schotland
Cleary, Gottlieb, Steen & Hamilton
2000 Pennsylvania Avenue, NW
Washington, D.C. 20006
(202) 974-1500

Counsel for The Electricity Consumers Resource Council, et al.

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Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF FOR RESPONDENT ELECTRIC POWER SUPPLY ASSOCIATION IN SUPPORT OF PETITIONER ENRON POWER MARKETING, INC.

JAMES VANR. SPRINGER
Counsel of Record
LARRY F. EISENSTAT
MICHAEL J. RUSTUM
STEVEN L. MILLER
DICKSTEIN SHAPIRO MORIN
& OSHINSKY LLP
2101 L Street, N.W.
Washington, D.C. 20037
(202) 785-9700

Counsel for Respondent Electric Power Supply Association

Wilson-Epes Printing Co., Inc. – (202) 789-0096 – Washington, D. C. 20001

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RULE 29.6 STATEMENT

The Electric Power Supply Association has no parent corporation and no publicly held stock.

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IN THE

Supreme Court of the United States

Nos. 00-568 and 00-809

NEW YORK, *et al.*,

Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,

Respondents.

ENRON POWER MARKETING, INC.

Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF FOR RESPONDENT ELECTRIC POWER SUPPLY ASSOCIATION IN SUPPORT OF PETITIONER ENRON POWER MARKETING, INC.

The Electric Power Supply Association ("EPSA") is the national trade association representing competitive suppliers of electric power throughout the United States. EPSA's members are dependent upon transmission-owning electric utility companies for the interstate transmission services needed to deliver wholesale power to their customers for ultimate distribution to retail customers.

EPSA submits this brief in support of Petitioner Enron Power Marketing, Inc. ("Enron"), to bring to the Court's attention matter relevant to an understanding of the practical impacts of the jurisdictional issues in this case. In this brief, EPSA explains how the Federal Energy Regulatory Commission's ("FERC") failure to exercise jurisdiction under the Federal Power Act ("FPA") over interstate electric transmission bundled with retail sales of power—which constitutes the majority of interstate electrical transmissions—has resulted in a regulatory gap that gives vertically integrated electric utilities significant advantages over, and incentives to discriminate against, other interstate users of the utilities' transmission systems. EPSA incorporates herein the introductory sections of Petitioner Enron's brief.

SUMMARY OF THE ARGUMENT

Interstate electrical transmission bundled as part of a retail sale of electricity is, in every respect but for how it is marketed and billed to the consumer, exactly the same as any other interstate electrical transmission that FERC regulates. It should thus be subject to the same regulations and nondiscriminatory open access transmission provisions set forth in FERC Order Nos. 888, 888-A and 888-B (referred to collectively herein as "Order No. 888")[1] with respect to unbundled interstate transmissions of electrical energy.

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[1] *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities and Transmitting Utilities*, Order No. 888 F.E.R.C. Stats. & Regs., Regulations Preambles January 1991-June 1996, ¶ 31,036 (1996); *Promoting Wholesale Competition Though Open Access Non-Discriminatory Transmission Services by Public Utilities and Transmitting Utilities*, Order No. 888-A, III F.E.R.C. Stats. & Regs. ¶ 31,048 (1997); *Promoting Wholesale Competition Though Open Access Non-Discriminatory Transmission Services by Public Utilities and Transmitting Utilities*, Order No. 888-B, 81 F.E.R.C. ¶ 61,248 (1997).

Indeed, it makes little sense for FERC to implement rules designed to promote nondiscriminatory open access to all users of the interstate electric transmission grid and then determine that the majority of interstate transmission use is not subject to those rules.

An examination of the practical consequences of FERC's choosing not to exercise jurisdiction over interstate transmission when bundled with retail sales highlights why the Court should overrule the Court of Appeals' affirmance of FERC's renunciation of comprehensive jurisdiction over interstate transmission. FERC's refusal to make interstate transmission bundled with retail sales subject to nondiscriminatory open access rules automatically allows utilities to discriminate in favor of the utilities' own sales, denying others equal access to interstate transmission. Because FERC's jurisdiction over interstate transmission is exclusive, its determination that it lacks jurisdiction over the majority of interstate transmission uses has created an unnecessary and unacceptable regulatory gap over the interstate transmission that a utility claims is used to serve retail customers. This absence of uniform governmental oversight has allowed public utilities to manipulate schedules and system dispatch to their own benefit without fear of discovery or serious reprisal.

ARGUMENT

FERC's decision creates a regulatory gap through which utilities can avoid government regulation and oversight over the bulk of their interstate transmission. A closer look at the practical nature and consequences of FERC's truncation of its exclusive jurisdiction to prevent undue preference or discrimination in the provision of all interstate transmission service confirms the error of that decision.

I. FERC'S DISAVOWAL OF ITS EXCLUSIVE JURISDICTION RELIES ON A MEANINGLESS DISTINCTION TO CREATE A REGULATORY GAP OVER THE MAJORITY OF INTERSTATE TRANSMISSION SERVICES.

Under Section 205 of the FPA,[2] Congress vested in FERC the exclusive authority to bar public utilities from granting any undue preference or advantage to any person with respect to interstate electric transmission service. Because FERC has determined that it lacks exclusive jurisdiction over transmission bundled with retail sales, there now is no regulatory supervision—either federal or state—to prevent undue discrimination or preference in the reservation and use of nearly two-thirds of the interstate electric transmission capacity in this country, which is used by utilities to serve retail customers.[3] FERC's creation of this regulatory gap is based upon the fallacy, to which the Court of Appeals deferred, that interstate transmission, when part of a retail sale and not billed to the customer as a separate service,

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[2] 16 U.S.C. § 824(d).

[3] In 1999, 3.2 billion megawatts of electricity were sold at retail on a bundled basis. Energy Information Administration, United States Department of Energy, *Electric Sales and Revenue 1999* at 3 (2000) (hereinafter *Electric Sales and Revenue*). Of these, approximately 2.81 billion megawatt hours were sold at retail by FERC jurisdictional generators: 2.4 billion by investor-owned utilities and 410 million by independent power producers. *See* Energy Information Administration, United States Department of Energy, *Financial Statistics of Major U.S. Publicly Owned Electric Utilities 1999* at 3 (2000). At most, 988 million megawatt hours of that 2.81 billion megawatts, or 34.1 percent, was previously sold for resale. *Id.* And, only 76.2 million megawatt hours (2.4 percent of retail sales) were sold on an unbundled basis, with the remaining 97.6 percent sold on a bundled basis. *See Electric Sales and Revenue 1999* at 245, 255 (2000) (showing transmissions of 76 million megawatt hours sold pursuant to retail wheeling programs, *i.e.*, on an unbundled basis). In total, therefore, almost two-thirds (1.75 billion of 2.8 billion megawatt hours) of pertinent transmissions were bundled with retail sales.

ceases to exist as such, becoming instead merely part of a retail sale that is beyond the Commission's jurisdiction. This is a distinction without meaning, and it produces conditions under which load serving utilities serving—or purporting to serve—their own retail customers can freely discriminate against other interstate transmission users, including utilities from neighboring regions that require transmission access to deliver power purchased on behalf of their own bundled retail customers.

The bundled/unbundled distinction fails to recognize that the inherent nature of interstate transmission of electricity does not change merely because it is bundled for billing purposes as a component of a retail sale of electricity. A utility's use of interstate transmission on behalf of its retail customers has all the same physical characteristics, utilizes the same transmission facilities, and crosses the same interstate borders as all other interstate transmissions of electricity. The only difference is whether the utility labels transmission as a separate product.

For most of the prior century, the Commission's jurisdictional posture with respect to the transmission component of retail power service reflected the physical and commercial reality that transmission was used exclusively to deliver a bundled product to captive retail customers. That such transmission went unregulated was both pragmatic and understandable in view of the states' regulation of retail power sales and the near complete absence of wholesale competition. This is, however, an antiquated view. FERC's exercise of its exclusive jurisdiction can no longer lie dormant. Transmission services now are a separate and separable component of nearly every delivery of electric power and should be regulated consistent with FERC's exclusive jurisdiction and responsibility to prevent discrimination, which the states are unable to remedy.

Notwithstanding the fact that interstate transmission service is easily separated into a verifiable component of retail sales, FERC has renounced its exclusive jurisdiction over the interstate transmission component unless transmission-owning utilities—the very ones who benefit from discriminatorily controlling access to their transmission facilities—make the unlikely choice voluntarily to unbundle interstate transmission service from their retail electric sales, or are ordered to do so as part of a state electric restructuring program that would unbundle retail sales to allow customers to choose their own retail suppliers of electricity. FERC's action effectively permits the parochial business and regulatory interests of utilities and states to determine the scope of FERC's jurisdiction over interstate transmission and, consequently, FERC's authority to remedy undue discrimination through imposition of nondiscriminatory open access transmission.

Given that Congress has granted comprehensive and exclusive jurisdiction over interstate transmission to FERC, the agency's abdication of that authority is impermissible. Indeed, it is in direct conflict with this Court's holding in *Phillips Petroleum v. Wisconsin*, 347 U.S. 672 (1954), where the Court held that the jurisdiction of the Federal Power Commission was not intended to vary from state to state, depending upon the degree of state regulation and of state opposition to federal control.

II. FERC'S STATUTORY INTERPRETATION PERPETUATES CONDITIONS THAT ALLOW TRANSMISSION-OWNING UTILITIES TO EXERCISE UNDUE DISCRIMINATION AGAINST OTHER USERS OF THE UTILITIES' INTERSTATE TRANSMISSION SERVICES.

The Court of Appeals' affirmance of FERC's legal error improperly legitimizes FERC's refusal to guard against abuses in the use of interstate transmission and perpetuates conditions that allow transmission-owning public utilities to

discriminate in favor of their own power sales and against entities that are dependent upon those public utilities' transmission systems to deliver or receive electricity. The following examples illustrate certain discriminatory practices that transmission-owning utilities have employed and continue to employ against transmission-dependent members of EPSA in the absence of regulatory oversight of all interstate electrical transmission.[4]

Improperly Blocking Available Transfer Capacity By Overscheduling Transmission For Retail Loads: Not being subject to FERC's nondiscriminatory transmission access rules, transmission owning utilities with captive retail customers can "block" available transfer capability (*i.e.*, the capability of the physical transmission network to accommodate further commercial activity over and above its committed uses) across valuable transmission paths or segments of the interstate transmission grid. They do so by heavily reserving capacity for their own use over such segments, claiming that the transmission capacity is needed to serve their own retail customers, whether or not such a need exists. Regardless of whether such action is intentional or the result of inaccurate calculations of available transfer capability, the result is the same. By limiting the publicly available transfer capability over a particular transmission path, the utility can block transmission-dependent entities from acquiring or selling low-cost power over that same path, and thereby prevent others from competing with the utility for that low-cost power. For example, a utility can post no

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[4] FERC, in *Regional Transmission Organizations*, Notice of Proposed Rulemaking, F.E.R.C. Stats. & Regs. ¶ 32,541, 33,709-10 (1999), discussed a Petition for Rulemaking (which EPSA supported) submitted in FERC Docket No. RM98-5-000 that set forth these and other examples of discriminatory treatment. FERC referenced this petition to highlight the need for further rulemaking to address ongoing discriminatory practices not cured by Order No. 888.

available transfer capability for a path traversing its system (A to B), thereby precluding a low-cost seller on one side of its system from selling power directly to a buyer on the other side. At the same time, however, the utility may post substantial available capacity from a point internal to its system to exit the system at point B, and may import the low-cost power from point A into its own system ostensibly for use to serve its retail load. This imported power can then be resold by the utility to the buyer at point B at a marked-up price insulated from the low-cost competition that would otherwise have occurred at point B.

Improper Avoidance of Costs: A transmission provider can purchase energy for peak service to its own retail load, schedule the import of that energy for the following day, and designate itself as the user of the energy for its retail load. This allows the transmission provider to pay no separate transmission charge to import the energy into its service territory. In the hourly market for the following day, the transmission provider or its marketing affiliate can sell the energy as "non-peak" to a neighboring service area and pay only a transmission charge for exporting that energy. Other transmission customers, however, would be prohibited from scheduling such power for a day ahead without charge, "parking" that power, and then deciding to transfer energy out in the hourly market. Rather, the other customers would have to pay for transmitting that power *into and out of* the initial transmission provider's system. During off-peak periods when a transmission provider is selling at wholesale the power it has paid nothing to import, its wholesale competitors are severely and unfairly disadvantaged. Under FERC's interpretation of the FPA, because utilities do not have to disclose their transmission for bundled retail service, this conduct is difficult, if not impossible to detect.

Failing To Make Accurate Disclosure Of Available Transfer Capability: Another consequence of FERC's jurisdictional determination is that utilities do not have to procure transmission on a comparable basis to their competitors, and therefore, do not have to report transmission reserved for their retail loads on the Open Access Same-Time Information System ("OASIS"; an internet-based transmission availability and scheduling system on which public utilities must publicly post transmission availability and transactions pursuant to Order No. 888's companion order, FERC Order No. 889 [5]). As a result, these utilities have no incentive to produce accurate calculations of available transfer capability. This can cause serious difficulties for suppliers attempting to schedule electricity sales across their transmission facilities. These reporting inaccuracies are cumulative in effect across geographic regions, often resulting in the underreporting of additional available transfer capability. This underreporting has serious consequences for suppliers and marketers that rely on OASIS information to schedule their power sales to buyers, at times forcing them to incur substantial losses due to the inability to schedule into regions where the amount of available capacity has been underreported.

These examples illustrate how FERC's abandonment of its jurisdiction and its concomitant limitation of applicability of Order No. 888 effectively nullify nondiscriminatory open access to interstate transmission. They also depict the opportunities for utilities to manipulate and frustrate wholesale competition and eliminate incentives for public utility transmission providers to accurately disclose surplus transmission capacity, particularly when transmission capacity is in high demand.

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[5] *Open Access Same-Time Information System and Standards of Conduct*, Order No. 889, F.E.R.C. Stats. & Regs., Regulations Preambles, ¶ 31,036 (1996).

Moreover, FERC's determination that it lacks jurisdiction over bundled transmission makes redress of these discriminatory practices under FERC's general enforcement procedures nearly impossible. The lack of public access to a utility's retail load and transmission data creates a considerable informational void given that the majority of transmission reservations are for bundled retail customers. Without OASIS postings or any other regulatory oversight for the majority of transmissions, it is difficult, if not impossible, for FERC or any potential competitor to obtain information to prove that transmission owning utilities are engaging in discriminatory conduct by manipulating their scheduling and system dispatch to disadvantage wholesale transmissions (the only transmissions over which FERC lays claim). Moreover, the types of discriminatory actions described above occur within a period of minutes or hours. By the time FERC conceivably could take any action, a disadvantaged competitor's business opportunity would have passed.

Likewise, any complaints to a state utility commission would be limited to addressing a transmission-owning utility's manipulation of bundled retail sales over which the state would have jurisdiction. The states have no jurisdictional authority to order a utility to provide wholesale transmission service. Even if state jurisdiction could be established over a transmission dispute, there likely would be a preference for constituents served by the transmission-owning utility versus the interstate business interests of energy wholesalers, such as EPSA's members. Where a transmission-owning utility engages in discriminatory acts that restrict an electricity wholesaler from serving customers in a neighboring state, the issue is an interstate dispute that should be subject to FERC jurisdiction.

Put simply, without FERC regulation of all uses of interstate transmission, including the transmission component of bundled retail power sales, meaningful redress of

discrimination will remain difficult, if not impossible, to attain.

CONCLUSION

The Court of Appeals' decision should be reversed insofar as it affirms FERC's holding that its jurisdiction does not include interstate transmission bundled with local retail service.

Respectfully submitted,

JAMES VANR. SPRINGER
Counsel of Record
LARRY F. EISENSTAT
MICHAEL J. RUSTUM
STEVEN L. MILLER
DICKSTEIN SHAPIRO MORIN
& OSHINSKY LLP
2101 L Street, N.W.
Washington, D.C. 20037
(202) 785-9700

Counsel for Respondent Electric Power Supply Association

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IN THE

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On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF ENRON POWER MARKETING, INC. AS RESPONDENT IN NO. 00-568

JEFFREY D. WATKISS
BRACEWELL & PATTERSON, L.L.P.
2000 K Street, N.W.
Suite 500
Washington, D.C. 20006
(202) 828-5800

JOSEPH R. HARTSOE
SARAH NOVOSEL
ENRON CORP.
1775 I Street, N.W.
Washington, D.C. 20006
(202) 828-3360

LOUIS R. COHEN
Counsel of Record
JOSEPH E. KILLORY, JR.
JONATHAN J. FRANKEL
IJAY PALANSKY
MICHAEL PLOTNICK
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, D.C. 20037-1420
(202) 663-6000

Counsel for Respondent Enron Power Marketing, Inc.

BEST AVAILABLE COPY

QUESTION PRESENTED IN NO. 00-568

By Order filed February 26, 2001, this Court granted certiorari with respect to the following question:

Whether, given that Congress in 1935 stated that federal regulation extends "only to those matters which are not subject to regulation by the states" (Federal Power Act (FPA) § 201)), and the transmission of energy from generators to retail customers in the same state was then "subject to regulation by the states" (as it has been since 1935), may the Federal Energy Regulatory Commission (FERC) preempt state jurisdiction over such intrastate retail transmission of electric energy?

PARTIES TO THE PROCEEDING

The list of parties before the court of appeals is set forth at No. 00-809 Pet. App. 683a to 688a.

RULE 29.6 STATEMENT

Enron Corp. is the only publicly held company owning 10% or more of respondent Enron's stock. The following companies are the parent companies of respondent:

Enron Corp.

Enron North America Corp.

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the District of Columbia Circuit is reported at 225 F.3d 667 (D.C. Cir. 2000) and reprinted at No. 00-809 Pet. App. 3a to 121a. FERC Order No. 888 is reported at F.E.R.C. Stats. & Regs. ¶ 31,036, 61 Fed. Reg. 21,540 (1996). FERC's rehearing decisions, Order No. 888-A and Order No. 888-B,

are reported respectively at III F.E.R.C. Stats. & Regs. ¶ 31,048, 62 Fed. Reg. 12,274 (1997), and 81 F.E.R.C. ¶ 61,248, 62 Fed. Reg. 64,688 (1997). Relevant portions of FERC Orders Nos. 888 and 888-A and FERC's Notice of Proposed Rulemaking (NOPR), F.E.R.C. Stats. & Regs. ¶ 32,514, 60 Fed. Reg. 17,662 (1995), are reprinted at No. 00-809 Pet. App. 125a to 644a.

STATUTES AND RULES INVOLVED

Sections 201, 205, 206, 211, 212, 213, and 313 of the Federal Power Act (FPA), 16 U.S.C. §§ 824, 824d, 824e, 824j, 824k, 824*l* and 825*l*, are reprinted in the Appendix at No. 00-809 Pet. App. 652a to 681a.

Sections 1, 4, and 5 of the Natural Gas Act (NGA), 15 U.S.C. §§ 717, 717c, and 717d, are reprinted in the Appendix at No. 00-809 Pet. App. 645a to 651a.

Relevant portions of FERC Orders Nos. 888 and 888-A are reprinted in the Appendix at No. 00-809 Pet. App. 125a to 551a.

STATEMENT

The Federal Power Act (FPA) gives the Federal Energy Regulatory Commission (FERC) jurisdiction over all "transmission of electric energy in interstate commerce" without any stated limitation. 16 U.S.C. § 824(b)(1). In the orders under review, FERC exercised this jurisdiction to prevent vertically integrated public utilities from using their ownership of the nation's interconnected high-voltage transmission facilities to discriminate against competing power suppliers needing access to those facilities. FERC ordered each utility to file an open access transmission tariff (OATT) and to take transmission service for its own wholesales and (where a state requires or the utility voluntarily offers unbundled retail service) unbundled retail sales on the same terms of access and usage as its transmission-dependent competitors. In an era in which

competing suppliers and users must all use interconnected grids with limited capacity, federal regulation of the terms of access to and usage of the grids pursuant to the authority granted in the FPA is indispensable to workable, nondiscriminatory operation.

Petitioners State of New York et al. (New York) argue that FERC's orders are an unlawful "preemption" of state jurisdiction over retail sales of electricity. But FERC has not exercised any authority over retail sales. The fact that FERC's rules governing access to and usage of transmission facilities may affect the utility's cost for transmission, which is one of the costs a utility incurs to provide retail electric service, does not mean that FERC has regulated any aspect of retail sales or taken any jurisdiction from the states. FERC's regulation of interstate transmission leaves the states' jurisdiction over prices and other terms of retail sales of energy to end users entirely intact.

New York's legal premise, that FERC's transmission jurisdiction is limited to transmissions for "wholesales," reads into the FPA a limitation that Congress intentionally omitted. New York's further suggestion that transmissions on the Nation's two multi-state grids can be teased into separate (and separately regulatable) intrastate and interstate components ignores the fact that the grids are operated as synchronized, interstate networks, and the energy on these grids does not observe state borders. *Every* use by a user connected to a grid draws on every generator connected to that grid, wherever located. There is no such thing as a purely intrastate transmission on the interstate grids. To permit the forty-eight contiguous states to regulate "their" portions of the transmission grids as separate fiefdoms—and to permit them, in times of shortage, to hoard capacity for their in-state customers or prevent electricity from leaving the state—threatens the transmissibility of electric power throughout the country that federal regulation is designed to

promote as well as the competitive electricity markets that Congress sought to effectuate.

A. The Interstate Electric Transmission Grids

Three broad categories of facilities are used to provide electricity to end users. *Generation* facilities produce electric energy. Networks of high-voltage *transmission* lines carry electricity from the generators to local distribution points. After the electricity is stepped down to lower voltages, *local distribution* facilities deliver electricity from the distribution points to end users. Although the broad distinction between high-voltage transmission facilities and low-voltage local distribution facilities is generally understood and has long been recognized by this Court, *see Connecticut Light & Power Co. v. FPC*, 324 U.S. 515, 534-35 (1945), the exact demarcation is a matter of definition.

Today, the transmission facilities in every state (except Alaska, Hawaii, and part of Texas) interconnect into two large reticulated grids, the Eastern and Western Interconnections. *See* Steven M. Kramer & Bret A. Sumner, *Electric Reliability in North America: Cross-Border Implications*, 14 Nat. Resources & Env't 81, 82 (1999); *see also* Order No. 888 at 31,781, Pet. App. 305a n.541.[1] Most parts of these grids are owned by the vertically integrated public utilities that have traditionally provided electricity to their local customers on a regulated-monopoly basis. *See* Order No. 888 at 31,652, Pet. App. 172a. The utilities use these facilities for bulk transmissions of the electric energy that they sell either at wholesale (i.e., to entities that in turn resell) or at retail (i.e., to end users who receive electricity via the utilities' local distribution systems). Other power suppliers that compete against the vertically integrated

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[1] All citations in this brief to "Pet. App." are to the Petitioner's Appendix filed with Enron's Petition for a Writ of Certiorari in No. 00-809.

utilities depend on the same transmission facilities to carry electricity to their customers.

Although customers and suppliers enter into bilateral contracts for the delivery of specific quantities of electricity, these contractual arrangements bear no resemblance to the physical behavior of electricity on the grids. A unit of electricity is not a discrete object that flows from a particular source to a particular buyer or user over a particular route, and a supplier generating electricity cannot prescribe the route over the grid that "its" electricity will follow. Each multi-state interconnection operates as a single pool of energy, into which generating facilities (wherever located) deposit electric energy, and from which customers (wherever located) draw it down.[2] Every connected use draws to some degree on every connected source, as the grid balances supply and use to ensure that the frequency of electric energy in the grid is maintained at a standard level, generally 60 cycles per second (or a multiple thereof). *See Florida Power & Light Co.*, 37 F.P.C. 544, 548, 564-65 (1967). "[A] load change at any point will have an effect on the instantaneous generation and frequency at every point on the interconnected system." *Id.* at 565. A sudden surge of use in Boston, or a downed high-voltage transmission line in New York, impacts electric operations in every state in the Eastern Interconnection. *See id.* at 548-50.

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[2] In this respect, the electricity network is very different from, for example, the telephone network. When one telephone caller dials another, the switches in the telephone network establish a dedicated circuit between them that remains open for the length of the call, and all communications between the callers travel over this fixed open pathway. By contrast, when a generating utility contracts with an end user to deliver electricity, nothing travels on any path between them: the utility generates an additional amount of electric energy for the grid, and the end user withdraws a corresponding amount of electric energy from the grid. *See Florida Power & Light Co.*, 37 F.P.C. 544, 548, 567 (1967).

B. Statutory Background

Early in the Twentieth Century, because electricity could be produced in many places but could not be successfully transmitted over long distances without substantial losses, the electricity business was almost entirely local. *See Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 681 (D.C. Cir. 2000), Pet. App. 9a; Order No. 888 at 31,639, Pet. App. 141a. Vertically integrated utilities, mostly confined to single states, each generated, transmitted, and distributed their own electricity, selling it to their retail customers on a bundled basis. "The industry consisted of independent, unassociated, local units [and] its piecemeal and planless development resulted in an uneconomic division of territory, wasteful overlapping of facilities, and lack of engineering and economic unity." Memorandum of Oswald Ryan, General Counsel of the Federal Power Commission (FPC), and Dozier A. DeVane, Solicitor of the FPC (Ryan-DeVane Memorandum), in *Public Utility Holding Company Act of 1935: Hearings on S. 1725 Before the Senate Comm. on Interstate Commerce*, 74th Cong. at 797 (1935).[3]

However, utilities gradually began to interconnect their generation and transmission facilities into regional networks. Interconnection permitted utilities to draw on more generation resources to meet variations in local demand and to achieve economies of scale by serving larger areas, allowing the utilities to enhance the reliability and profitability of their services. Increasingly, these networks crossed state lines; by 1933, roughly a dozen states either imported more than half their electricity from other states or exported more than half the power generated in-state to other states. *See* Ryan-DeVane Memorandum at 798 n.1.

Still, each of these regional networks grew in isolation. There was no coordinated planning of these networks,

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[3] The Ryan-DeVane Memorandum summarizes the history of the industry up to 1935.

because no regulator exercised jurisdiction over interstate transmission: "Electricity crossing State lines is in a no-regulation land, unrestrained by the power of the State which may not constitutionally control it, and unrestrained by the power of the Federal Government, which has not attempted to control it." *Id.* at 798. As a result, transmission capacity *among* these regional networks was very inadequate. During World War I, for example, many regions of the country suffered power shortages because there was insufficient transmission capacity to import electricity from areas with adequate supplies. *See id.* (quoting War Department findings that "owing to lack of flexible and capacious interconnections between adjacent power systems it was virtually impossible to reduce this shortage . . . by taking advantage of the diversity factor and by releasing for active use part of the installed reserves which interconnection would have rendered safely available"). The consensus among federal policymakers in the mid-1930s was that inadequate transmission capacity threatened the health of the economy by preventing utilities from taking advantage of non-local lower-cost generation sources and by forcing them to maintain uneconomically high local reserves of generation capability. *See id.* at 798-800 (collecting sources).

The legislative hearings and debates leading to the adoption of the FPA in 1935 established the strong need for *federal* action to encourage and oversee the interconnection of transmission facilities. *See id.* at 800; *see also Public Utility Holding Cos.: Hearings on H.R. 5423 Before the House Comm. on Interstate and Foreign Commerce*, 74th Cong. at 2129 (1935) (*Hearings on H.R. 5423*) (statement of Dozier A. DeVane, Solicitor of the FPC) ("[J]ust as the original impetus to interconnection was given by the Government during the World War in requiring any company having excess capacity to transmit its surplus current to nearby territory in need of it, now the [federal] Government must take the lead if we are to achieve the unification desired in the new war upon economic waste and instability,

unemployment, and the progressive destruction of basic natural resources.") (internal quotations and citation omitted). As the General Counsel and Solicitor of the FPC then noted, "the vast saving to be accomplished by the proper coordination of power facilities, and the need for a centralized control of the coordination process furnishes a formidable basis for the exercise of congressional power." Ryan-DeVane Memorandum at 800; *see also Hearings on H.R. 5423*, at 384 (statement of Clyde L. Seavey, Commissioner of the FPC) (the FPA "is designed to secure coordination on a regional scale of the Nation's power resources").

In the FPA, Congress accordingly declared that "the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation . . . of that part of such business which consists of the transmission of electric energy in interstate commerce . . . is necessary in the public interest." 16 U.S.C. § 824(a). Congress gave FERC's predecessor, the FPC, jurisdiction over all "transmission of electric energy in interstate commerce" and all "facilities" used for such transmission. *Id.* § 824(b)(1). It defined electric energy "in interstate commerce" as energy "transmitted from a State and consumed at any point outside thereof." *Id.* § 824(c). The FPC was also given the authority to establish regional industry councils to coordinate the development of the grid and was empowered to order utilities to interconnect their transmission facilities with one another. *See id.* §§ 824a(a)-(b).

The FPA addressed other problems in the electric industry as well. Congress gave the FPC jurisdiction over "the sale of electric energy at wholesale in interstate commerce," a second area where there was a gap between state and federal authority. *Id.* § 824(b). The phrase "at wholesale" was applied to *sales* in order to provide a "bright line" between sales transactions subject to FPC jurisdiction

and sales transactions regulated by the states.[4] The qualifier "at wholesale" was not applied to *transmissions* in interstate commerce, all of which were made subject to the Commission's jurisdiction. *See* Order No. 888 at 31,969, Pet. App. 338a ("statute . . . makes no distinction between wholesale transmission and retail transmission").

In addition, the FPA commanded the FPC to remedy "undue discrimination." Specifically, section 205 of the FPA, 16 U.S.C. § 824d, bars any public utility, "with respect to any transmission or sale subject to the jurisdiction of the Commission," from "grant[ing] any undue preference or advantage to any person or subject[ing] any person to any undue prejudice or disadvantage," *id.*, and requires each utility to file schedules setting forth its "practices," *id.* § 824d(c). Section 206(a), 16 U.S.C. § 824e(a), directed the FPC, whenever it determined that a practice was "unjust, unreasonable, unduly discriminatory or preferential," to cure the discrimination: the FPC "shall determine the just and reasonable . . . practice . . . to be thereafter observed and in force, and shall fix the same by order."

The structure of the electric industry changed dramatically in the last decades of the Twentieth Century. In response to the energy crisis of the 1970s, Congress adopted two statutes—the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. §§ 2601 *et seq.* (PURPA), and the Energy Policy Act of 1992 (EPAct), codified in pertinent part at 16

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[4] *See FPC v. Southern California Edison Co.*, 376 U.S. 205, 211-12 (1964). As the Court there explained, with respect to sales, Congress was responding to the Court's decision in *Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927), holding that the Commerce Clause barred states from regulating interstate wholesales. The wholesale/retail "bright line" served to distinguish jurisdictional from nonjurisdictional sales without case-by-case adjudication of Commerce Clause issues. There is no comparable distinction with respect to interstate transmissions, all of which are part of interstate commerce and have been subject to federal regulation since 1935. There is therefore no need for a "bright line" with respect to transmissions.

U.S.C. §§ 824j-824m—designed to encourage independent wholesale power suppliers to enter the market in competition with the traditional utilities. *See* Order No. 888 at 31,642-45, Pet. App. 147a-156a. These steps were extremely successful: by the early 1990s, "generating capacity added by independent producers exceeded capacity added by utilities." *Id.* at 31,643, Pet. App. 151a (citation omitted). Other competing suppliers also grew, including many traditional utilities that became electricity generators and marketers outside their "native" areas. *See id.* at 31,639, 31,641, Pet. App. 141a, 147a. Thus, the generation and marketing of power became the subjects of increasingly intense interstate competition. *See id.* at 31,635, 31,645-46, Pet. App. 131a-132a, 156a-157a.

With the boom in the number of competitive suppliers came a greatly increased demand for access to the interstate transmission grids. To reach their customers, the new suppliers of electric power needed to be able to purchase transmission services from their chief competitors, the traditional vertically integrated utilities that continued to own most segments of the interstate grids.[5] But grid owners had the incentive and the ability to cripple the new competitors by reserving their transmission facilities for their own transmissions and forcing competitors to make more expensive alternative transmission arrangements, or by manipulating the transmission "curtailment" process to bar competitors' power from the system during periods of system overload. FERC initially exercised its jurisdiction to regulate access to and usage of the interstate transmission grids by ordering transmission on a case-by-case basis under section 211 of the FPA, which authorizes FERC, upon application, to

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[5] FERC found that "these entities needed transmission service in order to compete in electricity markets." Order No. 888 at 31,643, Pet. App. 150a. In order for there to be competitive power markets, "all wholesale buyers . . . must have equal access to the transmission grid." NOPR at 33,049, Pet. App. 558a.

order a transmission owner to provide transmission services to other suppliers and marketers. *See* Order No. 888 at 31,646, Pet. App. 157a-159a. FERC soon found, however, that the problem of discrimination was too widespread and entrenched for case-by-case resolution, and it began a rulemaking to address the problem on an industry-wide basis. *See id.* at 31,673, Pet. App. 191a-193a.

C. The FERC Orders at Issue

In Order No. 888 and, on rehearing, Order No. 888-A, FERC found that the traditional utilities that own much of the interstate transmission grids have inherent incentives to discriminate against other suppliers and are actually doing so. Structural characteristics in the industry "make it inevitable that [the transmission-owning utilities] will act in their own self-interest to the detriment of others by refusing transmission and/or providing inferior transmission to competitors." Order No. 888 at 31,682, Pet. App. 214a; Order No. 888-A at 30,210, Pet. App. 436a. FERC found that vertically integrated utilities had in fact acted to harm competitors and competition, citing an "array of allegations and circumstances raised by customers in individual cases over the years." Order No. 888-A at 30,210, Pet. App. 435a. Examples in the record included refusals to transmit, dilatory tactics amounting to refusals to transmit, and refusals to offer comparable service. *See* Order No. 888 at 31,919-26, Pet. App. 315a-331a.

FERC recognized that, under sections 205 and 206 of the FPA, "it is our duty to eradicate unduly discriminatory practices." *Id.* at 31,682, Pet. App. 214a. In the current proceedings, FERC determined that a broad remedy was necessary because there was "more than sufficient reason to believe that transmission monopolists . . . will continue to engage in unduly discriminatory practices, unless we fashion a remedy to eliminate their ability and incentive to do so." *Id.* at 31,683, Pet. App. 216a-217a. FERC also held that it

had jurisdiction to adopt a remedy addressing interstate transmissions at wholesale and at retail when the retail service is unbundled: "Unlike our jurisdiction over *sales* of electric energy, which section 201 of the FPA specifically limits to sales at wholesale, the statute does *not* limit our *transmission* jurisdiction over public utilities to wholesale transmission." *Id.* at 31,781, Pet. App. 305a (emphasis added). "[W]hen a retail transaction is broken into two products that are sold separately," FERC held, "we believe the . . . unbundled transmission service involves *only* the provision of 'transmission in interstate commerce' which, under the FPA, is exclusively within the jurisdiction of the Commission." *Id.*, Pet. App. 306a.

The remedy FERC fashioned was "functional unbundling." FERC required every public utility to adopt and take service under an "open access transmission tariff" (OATT) containing terms to be applied to all transmissions for wholesale sales and *un*bundled retail sales. *Id.* at 31,654, 31,781, Pet. App. 178a, 306a. (Respondent Enron's separate petition in No. 00-809 challenges FERC's failure to apply the same requirement to transmissions for *bundled* retail sales.) The tariff covers conditions of access to and usage of the grid, such as reservation of capacity, scheduling of transmissions, and rules of priority when system conditions require curtailment of transmission. *See id.* at 31,721-44, 31,749-50, Pet. App. 254a-264a, 276a-278a; Order No. 888-A at 30,278-79, Pet. App. 456a-460a. FERC also required each utility to "state separate rates for wholesale generation, transmission, and ancillary services." Order No. 888 at 31,654, Pet. App. 178a. In sum, the OATT established that when a utility is selling at wholesale, or at retail on an unbundled basis, it must take transmission for itself on the same terms it offers to others.

At the same time, FERC acknowledged that its jurisdiction over high-voltage interstate transmission facilities did not extend to low-voltage local distribution

facilities, and it expressly noted state jurisdiction over the latter. *See id.* at 31,770-71, Pet. App. 281a-282a. FERC adopted a seven-factor test for distinguishing interstate transmission facilities from local distribution facilities, and it permitted the states to recommend precisely where to draw the jurisdictional line. *See id.* at 31,771, 31,783-84, Pet. App. 282a-283a, 311a-312a.

D. Proceedings in the D.C. Circuit

On petitions for review, the D.C. Circuit upheld FERC's orders against challenges that they exceeded FERC's jurisdiction. *See Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 681, 687 (D.C. Cir. 2000) (*TAPS*), Pet. App. 8a-9a, 20a-21a. The State of New York and other parties contended that FERC has no jurisdiction over interstate transmission for *any* retail sales, even unbundled ones. The D.C. Circuit rejected this contention, holding that the FPA confers jurisdiction over unbundled interstate transmission of electric energy whether it is then sold at wholesale or retail. *See* Pet. App. 34a-35a. The court noted that "[t]he Supreme Court has interpreted the language in FPA § 201 regarding FERC's jurisdiction over transmissions in interstate commerce" and that it was "bound by the High Court's dictates to conclude that the FPA gives FERC the authority to regulate the transmissions at issue here, whether wholesale or retail." *Id.* at 34a. Even if this Court had been silent and the FPA were ambiguous, the D.C. Circuit held, "we would be hard pressed to conclude that FERC's interpretation of § 201[ ] as giving it jurisdiction over both wholesale and retail transmissions is unreasonable or impermissible." *Id.* at 35a.

The D.C. Circuit also upheld against state challenge FERC's seven-factor test for distinguishing between interstate transmission facilities and local distribution facilities, which it called a reasonable construction of the FPA. *Id.* at 38a-39a. New York petitioned for certiorari

from this ruling, No. 00-568, but the Court did not grant that portion of New York's petition. *New York v. FERC*, 121 S. Ct. 1185 (2001).

SUMMARY OF ARGUMENT

Since its adoption in 1935, the FPA has given FERC jurisdiction over interstate transmission of electricity and required it to eliminate undue discrimination in access to and usage of the facilities used to provide such transmission. Recent sweeping changes in the structure of the electric industry—the interconnection of virtually all transmission facilities in 47 states into two interstate networks, and the proliferation of competitive suppliers needing access to these grids—have increased both the amount of transmission subject to FERC's statutory jurisdiction and the need for FERC to exercise its authority. But there is no need to change the definition of FERC's jurisdiction adopted in 1935. New York's suggestion that FERC has reinterpreted the FPA to preempt state authority over retail electricity rates seriously mischaracterizes the orders under review and ignores the FPA's language. Moreover, state-by-state regulation of the nation's interstate grids would be a practical impossibility and a recipe for state-against-state discrimination.

I. Section 201(b) of the FPA gives FERC plenary authority over "the transmission of electric energy in interstate commerce," as well as the facilities used to provide such transmission, without any stated limitation. Since every act of consumption by a customer connected to an interstate grid draws on every generator on that grid, wherever located, *all* electricity on the interstate grids is "transmi[tted] . . . in interstate commerce" as a physical and legal matter. New York's claim that the uses of these grids can be teased into intrastate and interstate parts is unworkable. New York's further suggestion that FERC's jurisdiction is limited to "wholesale" transmissions reads language into the FPA that

is not there (and, indeed, that Congress consciously omitted); the state's snippets from the legislative record do not support its case and cannot override the language of the statute. Finally, amicus California's argument that there is no such thing as an interstate transmission facility—that every transmission over a grid for retail sale is state-jurisdictional "local distribution" regardless of how many states it crosses and how high the voltage at which it is carried—ignores the FPA's, and the orders', express distinction between transmission and distribution.

II. The states' argument that FERC has usurped traditional state regulatory authority has no merit. FERC's orders prescribe nondiscriminatory terms of access to and usage of the nation's interstate transmission grids, something the states have never done. The fact that these access and usage terms may affect the cost of one component of retail electric service does not mean that FERC has invaded the states' authority to set retail rates and terms; state ratemaking has always had to respect the costs that FERC approves for the facilities and services in its jurisdiction. The orders expressly disclaim any intention to regulate distribution facilities and contain a test specifically designed to distinguish between the proper spheres of federal and state regulators.

III. FERC adopted the orders after concluding that the vertically integrated utilities that own the transmission lines comprising the Nation's two interstate grids engaged in widespread discrimination against independent power suppliers, and that industry-wide open access tariffs were the only means for ending this discrimination. Individual states could not legally, and cannot practically, address the problem. State regulation would encounter formidable problems under the Commerce Clause if states attempted to prescribe detailed terms of access to and usage of the interstate grids. Moreover, state-by-state regulation of interstate transmission would, as promised by amicus

California, lead to attempts by individual states to reserve electricity and transmission capacity for their own customers at the expense of non-residents, threatening the free movement of electricity across the nation to the areas facing shortages. Finally, the interstate grids operate (and must be operated) as unified interstate wholes; it is unrealistic to expect separate regulation by each of the states to result in workable rules for access and use.

ARGUMENT

FERC found that the utilities that own and operate the facilities over which electricity is transmitted in interstate commerce engage in pervasive "undue discrimination" in favor of their own uses and against competing uses of their transmission facilities. To remedy this (in part), FERC ordered each owner or operator to publish an OATT and to take interstate transmission for itself on the same terms it offers to others. Petitioner New York argues that (i) transmissions over the interstate grid for retail sales are for the most part not physically in interstate commerce and (ii) the "bright line" separating federal jurisdiction over wholesale *sales* from state jurisdiction over retail *sales* also applies to *transmissions*, barring FERC from regulating transmissions for retail sales. Amicus California[6] argues that

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[6] California represents its interest as amicus curiae as arising from the "electric utility disaster" that has befallen the Golden State, which California implies was caused by its ceding "to FERC regulatory jurisdiction over the [unbundled] retail transmission facilities of the State's three large investor-owned electric utilities." (Cal. Br. at 1.) Nothing could be further from the truth. It is widely recognized that, apart from the effects of low rainfall causing a shortage of hydroelectric generating capability, California's debacle was self-inflicted. Specifically, the California legislature and Public Utilities Commission caused the "disaster" by (1) requiring its utilities to purchase all of their power needs from two short-term exchanges at price-decontrolled wholesale prices and to resell that power to retail customers at regulated prices that turned out to be lower than the wholesale prices; and (2) doing this in a power market that had become supply constrained by the State's

(iii) interstate transmission, no matter the voltage or the number of states traversed, is part of "local distribution" if the ensuing transaction is at retail. All of these arguments are wrong: FERC may, only FERC can, and FERC must remedy the undue discrimination FERC found, so as to protect competition among suppliers and assure the efficient availability of electricity throughout the Nation.

I. FERC HAS JURISDICTION OVER ALL TRANSMISSIONS OF ELECTRIC ENERGY OVER THE INTERSTATE TRANSMISSION GRIDS.

New York argues that FERC lacks statutory jurisdiction to apply the OATT to transmissions for retail sales because (A) much of the electricity assertedly does not cross state lines and (B) in any event such transmissions are components of the retail sales and hence subject only to state regulation. Amicus California argues that (C) such transmissions are part of state-regulated "local distribution." All of these arguments ignore the plain language of the FPA and are wrong: no one quarrels with the states' exclusive jurisdiction over retail sales and over local distribution, but interstate

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refusal to permit the development of new generating capability, despite the burgeoning demand of a booming economy. *See San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator and the California Power Exchange*, 93 F.E.R.C. ¶ 61,121, at 61,351, 61,353, 61,360 (2001) (detailing disaster's causes); *see also* California State Auditor, *Energy Deregulation: The Benefits of Competition Were Undermined by Structural Flaws in the Market, Unsuccessful Oversight, and Uncontrollable Competitive Forces* 1-4 (Mar. 2001) (attributing California disaster to flawed state legislation and its implementation); S.A. Van Vactor & F.H. Pickel, *Money, Power and Trade: What You Never Knew About the Western Energy Crisis*, 139 Pub. Util. Fort. 32 (2001) (concluding that the California disaster was caused by poor planning, drought, excessive reliance on the spot market, and because "the richest state in the richest country in the world does not want to pay its bills").

transmission is a distinct activity that has been clearly subject to federal regulation since 1935.

A. All Transmissions of Electric Energy on the Interstate Grids Are "in Interstate Commerce" As Defined in the FPA.

Section 201(c) of the FPA, 16 U.S.C. § 824(c), provides that electric energy is deemed to be transmitted "in interstate commerce" if it is "transmitted from a State and consumed at any point outside of the State." New York seizes upon this definition to argue (NY Br. at 43-45 & nn.27, 28) that FERC has jurisdiction over only the particular "electrons" that cross state lines. This argument, which is contrary to several consistent decisions of this Court, misunderstands both the science of electric energy and the definition in section 201(c).[7]

This Court has made it clear that whether electricity is consumed in a state other than the generating state depends on "an engineering and scientific, rather than a legalistic or governmental" test. *See Connecticut Light & Power Co. v. FPC*, 324 U.S. 515, 529 (1945) (*CL&P*). Under this test, all transmissions over an interstate grid are in interstate commerce because electric energy from every generator connected to an interstate grid becomes part of a pool of energy that serves all load requirements. "All of the electric energy produced by all the generating units [on an interconnected system] is delivered to the common coordinated and integrated modern transmission system from which all of the customers are supplied." *Florida Power & Light Co.*, 37 F.P.C. 544, 566 (1967). The operator of a particular generator cannot control the flow of "its" electricity to a particular end user and, conversely, a given

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[7] California, eager to conflate interstate transmission with local distribution (as to which *see infra* pp. 28-31) insists exactly to the contrary. It expressly acknowledges the "technologically expansive scope of transmission in interstate commerce." (Cal. Br. at 11.)

user is served not by energy from a particular generator, either in or out of state, but by all generators connected to the grid. "[I]f a housewife in Atlanta on the Georgia system turns on a light, every generator on Florida's system almost instantly is caused to produce some quantity of additional electric energy which serves to maintain the balance in the interconnected system . . . ." *Id.* at 567-68, *quoted in FPC v. Florida Power & Light Co.*, 404 U.S. 453, 460 (1972) (*FP&L*).

This Court has recognized this "engineering and scientific" truth. In *CL&P*, the Court noted that the "[t]echnology of the business is such that if any part of a supply of electric energy comes from outside of a state it is, or may be, present in every connected distribution facility." 324 U.S. at 529. When end users are served by those distribution facilities connected to the interstate grid, they are, therefore, necessarily consuming energy from the pool served by all generators on the interstate grid. *See id.*

New York's argument that some of the energy flowing to a retail customer is identifiably intrastate, and hence beyond FERC's jurisdiction, is simply wrong. Regardless of the proximity of generator and user, if both are connected to an interstate grid it is not possible for the user to draw only on that generator without consuming any energy that originated out of state. *See Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 381 (1983). ("[I]t is difficult to say with any confidence that the power [an interconnected utility] provides to its [customers] at any particular moment originated entirely within the State."); *New England Power Co. v. New Hampshire*, 455 U.S. 331, 336 (1982) ("So long as the electricity produced at [a generator] continues to flow through [an interconnected] transmission network, it will be impossible to contain that electricity within [the generator's state] in any physical sense."); *Northern States Power Co. v. FERC*, 30 F.3d 177, 179 (D.C. Cir. 1994) ("There is no way to determine what

path electricity actually takes between two points or indeed whether the electricity at the point of delivery was ever at the point of origin."). None of the sources New York cites suggests otherwise.[8]

New York's converse suggestion (NY Br. at 43), based on the metaphor of red and white blood cells, that FERC's jurisdiction extends only to the particular electrons in each transmission that travel interstate, is contrary to this Court's interpretation of section 201 and is obviously unworkable. In *FPC v. Southern California Edison Co.*, 376 U.S. 205 (1964), the Court deemed all sales of energy at issue "in interstate commerce" even though only some of the energy came from outside the state in which it was consumed. *See id.* at 208-09 (wholesale sale of energy generated in California, Nevada, and Arizona to the city of Colton, California, was "in interstate commerce"); *see also California v. Lo-Vaca Gathering Co.*, 379 U.S. 366 (1965) (sale of natural gas intended for use (and used in part) by the pipeline in its operations was within the FPC's wholesale jurisdiction because such gas commingled with other gas sold for resale). The identification and separate regulation of electrons from interstate sources is impossible: "There is a commingling of energy from different sources at a bus [a point of interconnection] with the result that the energy which flows away from such bus is so fully commingled as to consist of energy which has entered such bus both from

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[8] The technical sources cited in footnote 28 of New York's brief do not support the contention that a customer's use of electric energy is or can be served exclusively by intrastate generation. The cited portion of *Introduction to Electrical Theory and Power Transmission* suggests only that a utility can generate the *amount* of energy necessary to offset the *amount* consumed by its native load, not that the energy consumed by the native load is somehow the "same" energy generated by the utility. *See* Robert H. Sarikas, *Introduction to Electrical Theory and Power Transmission*, 70, 82 (1995). New York's other citation, D. Fink & H. Beaty, *Standard Handbook for Electrical Engineers* 2-4 (1987), is unrelated to the point at issue.

interstate and intrastate sources." *FP&L*, 404 U.S. at 461-63; *see also Florida Power & Light Co.*, 37 F.P.C. at 550. To put this in the language of section 201(c), *whenever* a quantity of electric energy is "transmitted from [a generating facility in] a [connected] State," some part of the electric energy is "consumed at any point outside thereof . . . ." 16 U.S.C. § 824(c). Therefore, as Justice Douglas explained in dissent in *FP&L*, "every privately owned interconnected [transmission] facility in the United States . . . is within the FPC's jurisdiction." 404 U.S. at 471. Nothing in the words of section 201(c) requires that the definition of interstate transmission be applied, unworkably, to only the portion that is so consumed.[9]

Finally, the fact that all transmission over an interstate grid is "in interstate commerce" does not render section 201(c) "nugatory" as an original matter. (*See* NY Br. at 44-45.) Three states—Alaska, Hawaii, and part of Texas—remain unconnected to the interstate grids today, and many transmission facilities were not yet interconnected when the FPA was enacted to deal with the growing phenomenon of interconnection. *See supra* pp. 6-11. The transmissions falling within FERC's jurisdiction grew dramatically after 1935 because of increases in interconnection, not because of any change in the FPA or its interpretation.[10]

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[9] California's brief directly contradicts New York on this point, stating "when any part of the electricity moves across state lines, transmission all the way to the retail customer is transmission in interstate commerce." (Cal. Br. at 11.)

[10] New York's reliance on *Chemehuevi Tribe of Indians v. FPC*, 420 U.S. 395 (1975), is thus misplaced. The argument in that case was that changes in policy and technology justified giving the statute a meaning fundamentally different than its language allowed. *Id.* at 422-23. Neither FERC nor Enron has made any such argument here.

B. FERC Has Jurisdiction Over Interstate Transmissions for Both Wholesale and Retail Sales, Notwithstanding the States' Jurisdiction Over the Retail Sales Themselves.

New York argues that the FPA draws a "bright line" between wholesale sales and retail sales and that every activity that serves a retail sale, including interstate transmission, is therefore reserved to the states' regulatory authority. New York says this is so regardless of whether the transmission service is sold for a separate charge or is bundled with the price of the energy at retail.[11] But this is a misreading of the plain language of the statute. FERC's jurisdiction over transmissions of energy in interstate commerce does not depend on its jurisdiction over wholesales or on how the transmitted electricity is sold; the "bright line," which provides a clear and workable rule for dividing federal and state jurisdiction over *sales*, has no application to interstate transmissions. This is made clear by the language of section 201(b), this Court's precedents, and the legislative history.

Section 201(b) of the FPA, 16 U.S.C. § 824(b), contains two separate grants of jurisdiction. The first gives FERC jurisdiction over all "transmission of electric energy in interstate commerce," and the second gives FERC jurisdiction over "the sale of electric energy at wholesale in interstate commerce." Although Congress limited FERC's jurisdiction over "sales" to those "at wholesale," it omitted that limitation from the grant of jurisdiction over "transmission." The different language in the two grants was intentional and must be given effect. *See Russello v. United States*, 464 U.S. 16, 23 (1983) ("where Congress includes

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[11] Enron agrees with New York (NY Br. at 35-36) that whether the transmission charge and the electricity charge are bundled is a matter of bookkeeping and billing that does not affect the allocation of jurisdiction. Interstate transmission, however it is billed, is a separate activity subject to distinct regulatory jurisdiction.

particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion") (internal quotations and citation omitted).

This Court has interpreted the nearly identical parallel provision of the Natural Gas Act (NGA) to give FERC jurisdiction over all interstate transportation of natural gas, whether the transported gas is sold at wholesale or retail. Section 1(b) of the NGA grants jurisdiction over "[1] the transportation of natural gas in interstate commerce, [and] [2] the sale in interstate commerce of natural gas for resale." 15 U.S.C. § 717(b). In *FPC v. Louisiana Power & Light Co.*, 406 U.S. 621 (1972), the Court explained that "[e]ach of the these is an independent grant of jurisdiction and, though the Act's application to 'sales' is limited to sales of interstate gas for resale, the Act applies to interstate 'transportation' regardless of whether the gas transported is ultimately sold retail or wholesale." 406 U.S. at 636. The Court has an "established practice of citing interchangeably decisions interpreting the pertinent sections of the two statutes." *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981). That practice should be applied in resolving this basic structural point, which is common to both statutes, the later of which (the NGA) was modeled on the earlier. Thus, even if the FPA language were not clear on its face, this Court's interpretation of the nearly identical NGA language would be controlling. *See Maislin Indus., U.S., Inc. v. Primary Steel, Inc.*, 497 U.S. 116, 131 (1990) ("Once [this Court has] determined a statute's clear meaning, [it] adhere[s] to that determination under the doctrine of *stare decisis*, and we judge an agency's later interpretation of the statute against our prior determination of the statute's meaning.").

In fact, Congress rejected a proposal to rearrange the statute that was apparently intended to limit the FPC's

jurisdiction over transmissions to transmissions for wholesales. The National Association of Railroad and Utility Commissioners (NARUC, a predecessor of a petitioner in this case) proposed an amendment to the language that became section 201(b) that would have applied the "at wholesale" limitation to FERC's transmission jurisdiction: "The provisions of this title shall apply only to the transmission and sale at wholesale of electric energy in interstate commerce." *Hearings on H.R. 5423*, at 1660 (emphasis deleted). Congress did not accept this change and enacted the broader jurisdictional grant contained in section 201(b).

New York correctly states that the FPA drew a "bright line" between wholesale and retail sales. But none of the cases cited by New York suggests that this bright line applies to interstate *transmissions*. *See Public Util. Comm'n v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927) (state could not regulate "sale" of electric energy by Rhode Island company to Massachusetts company for resale); *Pennsylvania Gas Co. v. Public Serv. Comm'n*, 252 U.S. 23, 28 (1920) (state could regulate retail "sale" of interstate gas to local customers); *Missouri v. Kansas Natural Gas Co.*, 265 U.S. 298, 310 (1924) (regulation of "sale" of gas to retail customers, not "transportation"). An important doctrine arising out of these cases was "that the retail *sale* . . . was subject to state regulation" even if the commodity had been transmitted in interstate commerce, *see Arkansas Elec.*, 461 U.S. at 377 (emphasis added), but none of the cases suggests the need for a "bright line" dividing interstate transmissions.[12]

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[12] New York cites (NY Br. at 29) *Southern California Edison*, 376 U.S. 205, but that case and the cases cited therein hold only that the state may regulate rates for local retail sales, not that FERC's jurisdiction over the transmission of electric energy (or the transportation of natural gas) is limited to wholesale transmission (or transportation). *See Illinois Natural Gas Co. v. Central Illinois Pub. Serv. Co.*, 314 U.S. 498, 504-05 (1942);

This is consistent with the reason for the bright line: to make it easy to ascertain where interstate commerce would be deemed to end, thereby avoiding a case-by-case evaluation of out-of-state and in-state interests in particular sales. Any retail sale was to be deemed subject to state jurisdiction, even though the electricity had been transmitted (and perhaps previously sold) in interstate commerce. *See Arkansas Elec.*, 461 U.S. at 375-77; *Pennsylvania Gas*, 252 U.S. at 28. But this bright line has no logical application to transmission, because all interstate transmissions are by definition in interstate commerce; the line that needs drawing is, instead, between transmission and local distribution. *See infra* pp. 28-31.[13]

New York tries to override the clear language of the FPA by selectively citing legislative history. Of course, the Court does "not resort to legislative history to cloud a statutory text that is clear." *Ratzlaf v. United States*, 510 U.S. 135, 147-148 (1994).[14] In any event, the legislative

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Panhandle E. Pipeline Co. v. Pub. Serv. Comm'n, 332 U.S. 507, 517 (1947).

[13] It made sense to give the FERC jurisdiction over all interstate transmissions because there is no physical distinction between interstate transmissions that serve wholesale and retail sales. The terms of sale are matters of contract. The transmissions, whether for wholesale or retail, compete for the use of the interstate grids, and it is that competition for usage that FERC has sought to regulate by mandating that an "open access" tariff be filed by all owners and operators of the facilities. FERC's important objective, as shown *infra* pp. 39-44, can only be accomplished by federal regulation, and Congress built into the FPA the jurisdiction over interstate transmissions necessary to enable FERC to do so.

[14] *See also Board of Governors v. Dimension Fin. Corp.*, 474 U.S. 361, 374 (1986) ("Invocation of the 'plain purpose' of legislation at the expense of the terms of the statute itself takes no account of the processes of compromise and . . . prevents the effectuation of congressional intent."); *Garcia v. United States*, 469 U.S. 70, 78 (1984) ("We are not willing to narrow the plain meaning of even a criminal statute on the basis of a gestalt judgment as to what Congress probably intended.");

history specifically discussing jurisdiction over interstate transmission clearly indicates that plenary FERC jurisdiction was a separate purpose of the FPA.[15] By 1935, the fledgling development of regional interstate electric power systems had "outgrown the States as to the . . . transmission of power, not the distribution." *See* Ryan-DeVane Memorandum at 798. "Electricity crossing State lines [was] in a no-regulation land, unrestrained by the power of the State which may not constitutionally control it, and unrestrained by the power of the Federal Government, which ha[d] not attempted to control it." *Id.* at 797. Congress enacted the FPA to establish federal regulation over the "uncontrolled and uncoordinated . . . transmission of electricity . . . [which] obstruct[ed] the free flow of electric energy in interstate commerce," *id.* at 800, and to encourage the further development of coordinated interstate grids, *see id.* ("the need for a centralized control of the coordination process furnishes a formidable basis for the exercise of congressional power provided in title II of the present bill").

The passages from the legislative record that New York cites discuss the retail/wholesale distinction only in the context of jurisdiction over sales; they do not address jurisdiction over transmission.[16] For example, the 1935

Tennessee Valley Auth. v. Hill, 437 U.S. 153, 184 n.29 (1978) ("When confronted with a statute which is plain and unambiguous on its face, we ordinarily do not look to legislative history as a guide to its meaning").

[15] Contrary to New York's suggestion, the FPA was enacted to do more than create federal authority to set wholesale rates: "I do not have to tell the members of this committee that the actual fixing of [wholesale] rates is but a small part of the regulation sought to be accomplished by this bill." *Hearings on H.R. 5423*, at 2170 (DeVane testimony); *see also* S. Rep. No. 74-621, at 17 (1935) (explaining that the purpose of the FPA was to fill not only the "Attleboro gap," but also to reach "[o]ther features of this interstate utility business that are equally immune from State control either legally or practically").

[16] The same is true of amicus California's discussion of legislative history. For example, California cites Solicitor DeVane's statement (Cal.

Senate Report's discussion of the exclusions from federal jurisdiction, cited by New York (NY Br. at 23), focuses on the "retail sale of . . . energy in local distribution." S. Rep. No. 74-621, at 48 (1935). FPC Solicitor DeVane's much-cited comments contain considerable discussion in very general terms about the preservation of state authority, but none of his comments about jurisdictional boundaries suggests a limit on FERC's authority to regulate the rates, terms, and conditions of the transmission of electric energy in interstate commerce. *See Hearings on H.R. 5423*, at 497-98 (discussing limits on "retail" rates in the context of a discussion on the "retail sale" of electric energy). As for the few citations that do discuss transmission, New York either cites the legislative record out of context or, occasionally, misquotes it entirely. For example, New York twice mischaracterizes, by leaving off the final clause, the same statement of Solicitor DeVane about federal jurisdiction over transmission facilities. (*See* NY Br. at 22, 33.) He actually said that federal jurisdiction did not extend to "jurisdiction . . . over facilities used in local distribution or the transmission facilities that are used in connection with such local distribution *unless they are also part of the facilities that are used in interstate commerce.*" *Hearings on H.R. 5423*, at 548 (emphasis added). Leaving out the "unless"

Br. at 10-11): "The bill does not give the Commission jurisdiction over energy that is transmitted in interstate commerce by a particular company and sold by that company to consumers." The statement was made in a discussion of jurisdiction over retail and wholesale sales rates. When read in context, it is clear that Solicitor DeVane's statement simply distinguished between the FPC's authority to set wholesale sales rates and the states' authority to set retail sales rates, even when the energy sold at retail was "transmitted in interstate commerce." DeVane's comment does not suggest any limit on FERC's jurisdiction over the transmission of electric energy in interstate commerce.

clause dramatically changes the meaning, which is entirely consistent with section 201(b).[17]

C. FERC's Jurisdiction Over Interstate Transmissions Is Not Limited by Section 201(b)'s Exclusion of Facilities Used in "Local Distribution."

The FPA excludes from FERC's jurisdiction "facilities used in local distribution." 16 U.S.C. § 824(b). Amicus California makes the novel argument (Cal. Br. at 8 *et passim*) that *all* conveyance of electricity, from a generator wherever located, over facilities of any character, at whatever voltage, and regardless of state boundaries, is actually "local distribution" if the only sale is to a retail customer. According to California, "local distribution" is "a subset of . . . transmission in interstate commerce." (*Id.* at 8.) A transmission at high voltage over the interstate grid from generation facilities in New York to a distribution point in Ohio and thence to retail customers would all be "local distribution" unless there was an intervening wholesale. This argument, under which the local distribution exception would swallow most of FERC's jurisdiction over transmission, is contrary to the statute and this Court's established understanding of what it means.

The FPA makes it quite clear that "transmission" and "local distribution" are distinct activities. Section 201(b)

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[17] New York argues that in earlier briefs to this Court and before Congress FERC has taken the position now urged by New York. All of the examples noted by New York, however, merely confirm FERC's recognition of state jurisdiction over retail sales and the local distribution of electric energy; in none does FERC deny or limit its own jurisdiction over interstate transmissions. For example, New York claims (NY Br. at 28) that in a December 1944 brief the FPC "conceded that the states regulated *all aspects* of retail transactions" (emphasis added), but the brief in fact acknowledges only that states have jurisdiction over the rates for "*sale* to the ultimate consumer." FPC's December 1944 Brief in *CL&P* at 28 (emphasis added).

says, "The Commission shall have jurisdiction over [1] all facilities for [interstate] transmission . . . but shall not have jurisdiction . . . over [2] facilities used in local distribution or [3] only for the transmission of electric energy in intrastate commerce." The statute is quite evidently using "transmission" and "local distribution" to mean different things. Moreover, California's view would prove too much: by California's definition, *all* transmission facilities are "used in local distribution" (at least some of the time) and hence beyond FERC's jurisdiction. If Congress actually meant, as California contends, to exclude all interstate transmissions for retail sales, it could have said so much more directly.

This Court has previously observed that there is a clear distinction between "transmission" and "local distribution" facilities (although the exact location of the line between them has been a matter of some specific disputes). In *CL&P*, on which California relies, the issue came down to whether the transformer facilities used in "the process of reducing energy from high voltage to low voltage in subdividing it to serve ultimate consumers," 324 U.S. at 534, were "transmission" facilities or "local distribution" facilities. The Court had no difficulty with the general distinction between the two:

> [T]ransmission . . . extends from the generator, where generation is complete to the point where the function of conveyance in bulk over a distance, which is the essential characteristic of 'transmission,' is completed and the process of subdividing the energy to serve ultimate consumers, which is the characteristic of 'local distribution,' is begun.

Id. at 533 (citations omitted). The Court instructed the court of appeals to remand the case to the FPC to determine on which side of the line the particular transformer facilities at issue fell. *Id.* at 534-36; *see also Southern California Edison*, 376 U.S. at 210 n.6 ("Whether facilities are used in

local distribution . . . involves a question of fact to be decided by the FPC as an original matter.").[18] The Court's reasoning and the result in *CL&P* make it clear that "transmission" and "local distribution" are essentially different activities.

The Court has drawn a similar distinction under the parallel provision of the NGA. Section 1(b) of the NGA gives FERC jurisdiction over the "transportation of natural gas in interstate commerce," but not over "the local distribution of natural gas . . . to the facilities used for such distribution . . . ." 15 U.S.C. § 717(b). In *FPC v. East Ohio Gas Co.*, 338 U.S. 464 (1950), the utility argued, as California does here, that all of its facilities used to transport gas to its retail customers were facilities for local distribution, exempt from federal jurisdiction even if used to transport gas in interstate commerce. *See id.* at 469-70. The Court rejected this "strained" interpretation, noting that it would exempt every pipeline owned by a vertically integrated utility and used to serve its retail customers. *Id.* at 470-71. The Court held that Congress intended by the language of the statute to create a clear distinction between the two types of facilities—"transportation" facilities carrying gas at high pressure and "local distribution" facilities carrying gas at reduced pressures to local users—even when both types of facilities are being used to serve a utility's own retail customers. *See id.*

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[18] Contrary to California's argument (Cal. Br. at 18-19), the Court's n.6 in *Southern California Edison* does not suggest that any facility "used" in retail service is *ipso facto* a "local distribution" facility. The Court merely noted that the FPC had found, in a particular instance, that certain facilities were *not* engaged in local distribution because they were used to serve wholesale customers. That FPC reasoning makes perfect sense and does not imply that, conversely, all facilities used to serve retail customers are local distribution rather than transmission facilities. On the contrary, the Court made clear that the line between "transmission" and "local distribution" facilities is to be determined by the expertise of the agency, applied to the particular facts of each case, and is not a simple bright line between wholesale and retail.

California asserts (Cal. Br. at 23-24 & n.16) that *CL&P* casts doubt on the reasoning of *East Ohio Gas*. But both cases recognize distinctions—indeed, roughly parallel distinctions—between facilities used to carry a commodity in bulk over long distances and facilities used for local distribution to customers. *Compare East Ohio Gas*, 338 U.S. at 470-71 *with CL&P*, 324 U.S. at 533-34. Both cases concerned which side of the line particular intermediate facilities fell on, and the Court held in *CL&P* that the analysis of particular gas facilities in *East Ohio Gas* did not control the analysis of particular electric facilities in *CL&P*. *East Ohio Gas* is also not, as California argues (Cal. Br. at 24 & n.16), inconsistent with the (much earlier, pre-NGA) decision in *Pennsylvania Gas*, 252 U.S. 23. *Pennsylvania Gas* held only that the states had authority to regulate retail "sales" because they were a matter of local concern, *see id.* at 28; it did not hold that states have the power to regulate interstate transmissions for those sales. To the extent Congress "adopted" *Pennsylvania Gas* in the FPA, it did so by leaving retail "sales" jurisdiction to the states.

Congress later overturned the outcome in *East Ohio Gas* by amending the NGA to add section 1(c), 15 U.S.C. § 717(c), which now exempts from federal regulation an entity that receives gas at or within the boundaries of a state if all of the gas is used within the same state. This section, known as the Hinshaw Amendment, which has no parallel in the FPA, does not alter the distinction between transportation of gas (or transmission of electricity) and local distribution. It merely implements an overriding policy that gas companies engaged entirely in in-state activities should be subject only to state regulation. There was inserted into the Senate Report on this legislation the phrase "as always has been intended," *see* S. Rep. No. 83-817, at 1-2 (1953), but this does not retroactively alter the meaning of the NGA's original language, particularly the language with respect to the distinction between transportation and local distribution, which was not changed. *See Mackey v. Lanier Collection*

Agency & Serv., Inc., 486 U.S. 825, 839 (1988) (opinion of "later Congress as to the meaning of a law enacted 10 years earlier does not control the issue"); *United States v. Price*, 361 U.S. 304, 313 (1960) ("the views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one").

II. FERC REGULATION OF ACCESS TO AND USAGE OF THE INTERSTATE GRIDS DOES NOT USURP ANY JURISDICTION THAT THE FPA RESERVED TO THE STATES.

The Declaration of policy in section 201(a) of the Federal Power Act provides:

> Federal regulation of . . . the transmission of electric energy in interstate commerce and the sale of electric energy at wholesale in interstate commerce is necessary in the public interest, such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States.

16 U.S.C. § 824(a). Following this declaration, section 201(b) gives FERC jurisdiction over the transmission of electric energy in interstate commerce and the sale of electric energy at wholesale in interstate commerce "but . . . not [over] any other sale of electric energy" and not over "facilities used in local distribution." 16 U.S.C. § 824(b). New York contends that Orders 888 and 888-A, insofar as they regulate transmissions of electric energy for retail sales, encroach upon state authority to regulate such sales. Amicus California contends that interstate transmission facilities become "local distribution" facilities when used for transmission of energy for retail sales and the orders therefore violate the states' reserved right to regulate local distribution.

Both of these arguments are wrong. FERC's exercise of its authority to regulate the terms and conditions of interstate

transmissions, an authority expressly granted by the statute, sets conditions that the states may be required to take into account in regulating retail sales, just as they must take into account FERC-fixed wholesale prices, but it does not usurp state regulation of rates for retail sales as such, or any state authority over retail sales. And FERC has made it entirely clear that it has not attempted to regulate local distribution facilities.

A. FERC's Regulation of Access to and Usage of the Interstate Grids Does Not Encroach Upon State Regulation of Sales of Electric Energy at Retail.

New York places far more weight on the Declaration of Policy in section 201(a) than it can properly bear. The section declares that *federal* regulation of interstate transmission of electric energy is "necessary in the public interest." To the extent that this policy is limited by reference to matters "subject to regulation by the states," the Court has made it clear that this general policy limitation yields to the specific grants of jurisdiction elsewhere in the statute. *See Southern California Edison*, 376 U.S. at 215 ("Section 201(b) embodies a clear grant of power, and we have held that [section] 201(a) was merely a 'policy declaration . . . of great generality. It cannot nullify a clear and specific grant of jurisdiction, even if the particular grant seems inconsistent with the broadly expressed purpose.'") (quoting *CL&P*, 324 U.S. at 527); *United States v. Public Utilities Comm'n*, 345 U.S. 295, 310-11 (1953) ("[Section] 201(a) was originally drafted as a declaration of 'policy,' and . . . [i]t cannot nullify a clear and specific grant of jurisdiction . . . ."). [19] FERC's orders have not encroached on any jurisdiction granted or reserved to the states by the FPA.

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[19] New York's reliance (NY Br. at 11, 28, 37-41) on *Jersey Central Power & Light Co. v. FPC*, 319 U.S. 61 (1943), for the proposition that section 201(a) grants the states jurisdiction over interstate transmission of electric energy for sale at retail is incorrect. *Jersey Central* merely noted

1. FERC's Orders Do Not Regulate Sales of Energy at Retail.

FERC's orders do not purport to regulate any aspect of the terms and conditions on which any utility sells electric energy at retail. *See* Order No. 888 at 31,635-36, Pet. App. 131a-134a (describing main aspects of the order). FERC's orders deal with terms of access to and usage of the interstate grids. The orders respond to findings of pervasive undue discrimination by vertically integrated utilities against competing power suppliers. The OATT was designed to level the playing field by requiring transmission owners to take their transmission on the same terms they offered their competitors, including access, curtailment policies, service priority ("firm" versus "non-firm" service), price, and service options and flexibility.[20]

FERC's regulation of access to and usage of the interstate grids to remedy undue discrimination is not regulation of retail sales. New York argues that because the OATT covers rates charged by transmission owners for interstate transmission service, and because the rate for the interstate transmission service is a component cost that the state must take into account in establishing the charges to retail customers for electricity, the OATT regulates the sale of energy at retail. (*See* NY Br. at 7-8, 11-12, 28-33.) But

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that the policy set forth in section 201(a) had no application to the provisions of the FPA dealing with "corporate financial arrangements" and was properly considered in connection with the interpretation of the FPA provisions dealing with generation, transmission, and sale. *See id.* at 74-75. *Jersey Central* did not opine about the effect of section 201(a) with respect to generation, transmission, and sale, and did not hold that section 201(a) preserved any transmission jurisdiction to the states.

[20] Contrary to the impression that might be gained from New York's brief, the orders are not concerned exclusively, or even primarily, with transmission *charges*. Their central concern is terms of access and usage. *See TAPS*, Pet. App. 8a ("open access is the essence of Order[] 888"). *See infra* pp. 39-40.

the amounts that a local utility must or may charge its retail customers, the manner in which these amounts are presented on a retail bill, whether customers will be allowed to choose among energy suppliers, and all of the other terms and conditions of retail service remain matters wholly within the authority of each state.[21] To be sure, the states are not free to ignore FERC-established costs and conditions of interstate transmission insofar as these, under state law, affect retail charges. State rate regulation, if designed to allow the utility to recover its costs, must respect the rates set in tariffs filed with FERC for components of electric service that are within FERC's jurisdiction. *See Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 969-70 (1986). But the fact that the utility must pay FERC-filed charges for some of the component costs it incurs, and that the state must recognize this, does not make the federal government a regulator of retail rates any more than does the Federal Communications Commission's regulation of the long-distance charges paid by utilities in the course of doing business.

The situation parallels the allocation of jurisdiction over wholesale and retail rates. FERC has undisputed jurisdiction over the former, and the states have undisputed jurisdiction over the latter. A FERC-filed wholesale rate for power establishes a cost component for a utility that obtains power as a buyer at wholesale at that rate. In such situations, the state is not at liberty, in setting retail rates based on a utility's costs, to ignore the FERC-filed wholesale rate. As this Court explained in *Nantahala*, in setting the retail rate, the state regulator must "recognize a FERC-approved [wholesale] price as a reasonable cost for purposes of retail ratemaking." *Id.* at 973. But the fact that FERC establishes wholesale rates that the states are required to honor in setting retail rates does not mean that FERC is itself regulating retail sales. This

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[21] This authority is of course subject to the constitutional rights of the regulated utilities. *See Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989).

principle applies equally to interstate transmissions, which like purchases at wholesale, are necessary components of electricity service at retail. As New York acknowledges (NY Br. at 9), all that Order No. 888 requires is that "the states that have separately identified the commodity . . . must incorporate FERC's transmission rate into the non-commodity . . . portion of the retail bill."[22]

In requiring a tariff setting forth terms and conditions for transmissions in interstate commerce, FERC has exercised only its own proper jurisdiction. Any resulting effect on state regulation of retail rates is not a usurpation but a consequence of a proper exercise of federal authority.

2. *The Matters FERC Has Regulated in Orders No. 888 and 888-A Are Not "Subject to Regulation by the States."*

New York also argues that because the states have always regulated all aspects of the sale of electricity at retail, and because interstate transmission costs are one component that must be taken into account in setting charges to the retail customer, jurisdiction over interstate transmission is reserved to the states under section 201(a). (*See* NY Br. at 11-12, 27-28.) But the states have never regulated competitive access to and usage of the interstate grids. The need for such regulation did not arise in its present form until the 1980s, with the birth of competition among suppliers of electricity.

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[22] The Court has reached a similar conclusion under the NGA. In *LP&L*, the Court held that similar regulation by the FPC of access to and usage of interstate natural gas transportation facilities, pursuant to section 1(b) of the NGA, did not constitute retail ratemaking, and fell squarely within the FPC's jurisdiction over interstate transportation. *See* 406 U.S. at 637-38 ("[Section] 1(b) withheld from FPC only *rate-setting* authority with respect to direct [i.e., retail] sales. Curtailment regulations are not *rate-setting* regulations but regulations of the 'transportation' of natural gas and thus within FPC jurisdiction under the opening sentence of § 1(b) that 'the provisions of this Act shall apply to the transportation of natural gas in interstate commerce.'").

No form of regulation in which the states have ever engaged, or in which the FPA permits them to engage, would enable the states to provide for nondiscriminatory access to the interstate grids or for interstate transmission service on fair and equal terms for all users.

That such regulation was within the proper scope of federal power was implicitly recognized in the EPAct of 1992. In that legislation, to help address the access problems plaguing the system, Congress amended section 211 of the FPA, 16 U.S.C. § 824j, to authorize FERC to order utilities on a case by case basis to "wheel" power for other users over their interstate transmission facilities. The broader actions taken in the orders resulted from FERC's determination that a case-by-case approach was not sufficient to remedy the pervasive undue discrimination it had found. *See* Order No. 888 at 31,646-47, 31,673, Pet. App. 157a-159a, 191a-193a. FERC noted that its authority under section 206 to remedy undue discrimination was unaffected by the amendment of section 211. *See* 16 U.S.C. § 824k(e) (savings provision stating that section 211 "shall not be construed as limiting or impairing any authority of the Commission under any other provision of [the FPA]"); Order No. 888 at 31,673, Pet. App. 192a (section 211 "left unaltered the authorities and obligations of the Commission under sections 205 and 206 . . . to remedy undue discrimination"). Traditional state regulation of retail sales and local distribution facilities had no way of dealing with the access and usage issues that Order No. 888 addressed; FERC's orders are qualitatively unlike anything the states have ever done.[23]

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[23] New York's reliance (NY Br. at 20-21, 25) on FPA legislative history discussing the *Shreveport Rate Cases* to support its assertion that the FPA reserved jurisdiction to the states beyond that set out in section 201(b) is misplaced. The issue in *Shreveport* was the Interstate Commerce Commission's authority to set rates for *intra*state rail shipments, *see Houston, E. & W. Texas Ry. Co. v. United States*, 234 U.S. 342 (1914); FERC has not sought to do anything comparable to this. Nothing in the 1935 congressional discussion of *Shreveport* suggests that

B. The Orders Under Review Expressly Provide for Continued State Regulation of Facilities Used in Local Distribution.

Section 201(b) of the FPA leaves to the states jurisdiction over all "facilities used in local distribution." 16 U.S.C. § 824(b). These local distribution facilities are composed of distribution lines connecting retail customers with distribution hubs, at which the high voltage energy transmitted through the grid is converted into lower-voltage energy suitable for distribution and bulk electric energy is subdivided for distribution to retail customers. *See CL&P*, 324 U.S. at 533. Distribution facilities are quite distinct from the high-voltage transmission facilities that make up the interstate grids. *See id.*

Order No. 888 sets forth a seven-factor test for distinguishing between interstate transmission facilities and local distribution facilities, with the express purpose of observing the FPA's jurisdictional division. *See* Order No. 888 at 31,770-71, Pet. App. 281a-283a. California asserts (Cal. Br. at 7-18) that there is no physical distinction between "transmission" and "local distribution" and that an interstate transmission for a retail sale is a part of local distribution. But as Enron showed at pp. 28-31, *supra*, that assertion is wrong. *See* 16 U.S.C. § 824(b) (distinguishing between facilities used for "transmission" and facilities used in "local distribution"); *East Ohio Gas*, 338 U.S. 464 (rejecting argument that, when used to move energy for retail sale, local distribution facilities include interstate transmission facilities). There have been disputes from time to time about whether particular facilities belonged on the "transmission" or the "local distribution" side of the line, but there is no support for California's creative argument that there is no

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a state, seeking to regulate the total delivered price of goods to its customers, would be free to dictate charges for interstate shipments or to ignore interstate rates set forth in a tariff filed with the ICC.

line at all. There is a line, and it preserves plenary state jurisdiction over facilities used in local distribution.

III. ONLY FERC CAN PROVIDE FOR NONDISCRIMINATORY OPEN ACCESS TO THE INTERSTATE GRIDS.

The practical case for FERC Orders No. 888 and 888-A (and, indeed, for much more complete FERC regulation to secure open access, *see* Enron's brief as petitioner in No. 00-809) may be summarized as follows: (1) Traditional provision of electric service on a monopoly basis by vertically integrated utilities is being supplemented, as a result of congressional action and other factors, by a regime of competition among suppliers of electricity. (2) The new suppliers, including traditional utilities competing outside their native markets, are dependent on nondiscriminatory access to interstate transmission facilities. (3) Nondiscriminatory access can be assured only by requiring the owners and operators of interstate transmission facilities to (a) take transmission on the same terms and conditions as they offer to others, which in turn requires them to (b) publish (and take service pursuant to) open access tariffs covering the reservation of transmission capacity, scheduling of transmission service, the resolution of conflicting demands, the steps to be taken when system constraints require curtailment of transmissions, the charges for transmission, and other similar matters. (4) Because the facilities are connected into interstate grids, only FERC is in a position to impose a workable open access tariff requirement; attempts by the states to mandate nondiscriminatory open access—even if they were motivated to do so—would produce chaos.

FERC's action was needed to safeguard and promote the nationwide competition in the supply of electricity that Congress sought to foster through PURPA and the EPAct, since alternative suppliers cannot compete if they cannot

move their electricity into the markets where it is needed. This objective is even more important today than when Congress enacted these statutes. Several parts of the nation are currently facing electricity shortages made worse by the fact that capacity on the interstate grids is not always available to bring electricity from other parts of the country. *See* Rebecca Smith & John R. Emshwiller, *Down to the Wire: Why California Isn't the Only Place Bracing for Electrical Shock*, Wall St. J., Apr. 26, 2001, at A1; William Claiborne, *Energy Forecasts for Summer: No Blackouts But Price Spikes*, Wash. Post, Apr. 30, 2001, at A3.

The regulation needed to provide nondiscriminatory open access, which is provided in part in Orders No. 888 and 888-A, is not concerned exclusively or even primarily with dollar charges for transmission. It must deal with issues of equal, open, and transparent access to information about the physical state of the transmission grids, uniform procedures for reserving and scheduling transmission capacity, the provision and purchase of various ancillary services that may or may not be provided with transmission, and issues of response to system constraints. Such regulation depends on known rules, contained in a published tariff, that treat comparable suppliers or users comparably. *Cf. AT&T Co. v. Central Office Tel., Inc.*, 524 U.S. 214, 221-22 (1998) (explaining that under the Communications Act every carrier must file a tariff showing all charges, classifications, practices, etc., for the purpose of preventing "unreasonable and discriminatory charges"). Without such published rules, suppliers and users that are dependent on the transmission facilities of others cannot plan, or compete, or offer the same degree of reliability as the transmission owners can promise, and no regulator can police transmission service against undue discrimination.

Only FERC is in a position to require the transmission-owning utilities to file and abide by the needed open access tariff. No state has ever attempted to exercise any such

power; there is no history of state regulation of the terms of access and use of interstate transmission facilities in order to assure appropriate and fair sharing by all competing users. And there are at least three reasons to believe the states could not do so.

First, any attempt by the states to provide detailed terms for access to the interstate grids would raise formidable issues under the dormant Commerce Clause. "[T]ransmission of energy is an activity particularly likely to affect more than one State, and its effect on interstate commerce is often significant enough that uncontrolled regulation by the States can patently interfere with broader national interests." *Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 351, 377 (1983). *Cf. Pennsylvania v. West Virginia*, 262 U.S. 553, 596-97 ("A state law . . . which by its necessary operation prevents, obstructs or burdens such transmission is a regulation of interstate commerce—a prohibited interference."), *aff'd*, 263 U.S. 350 (1923). The Court has stated more than once that the FPA did not grant the states any regulatory powers that the Clause would otherwise have denied. *See Wyoming v. Oklahoma*, 502 U.S. 437, 458 (1992); *New England Power Co. v. New Hampshire*, 455 U.S. 331, 341 (1982) ("Nothing in the legislative history or language of the [FPA] evinces a congressional intent to alter the limits of state power otherwise imposed by the Commerce Clause") (internal quotations and citation omitted).

Second, state regulation of access to the interstate grids would almost inevitably tend to favor in-state uses. Amicus California acknowledges this outright. Its stated purpose for opposing FERC's orders is to obtain the power to allow California utilities to discriminate, in the use of the interstate grid, in favor of California's retail customers: "In times when transmission is short, because of equipment failure or capacity constraints, States commonly require electric utilities to protect first the retail customers to whom public

utility obligations are owed (and in whose interests the utility is given its service monopoly by State law)." (Cal. Br. at 29.)[24] Such a priority for California's retail customers (as compared, for example, with retail customers in another state who are also dependent on transmissions over facilities located in California) may or may not be the best outcome under given conditions, but the state itself is not in a good position to be the judge.[25]

The threat of such parochial state regulation at odds with broader national or regional interests is very real. A similar argument supporting discrimination in favor of in-state customers was upheld by the Eighth Circuit in *Northern States Power Co. v. FERC*, 176 F.3d 1090 (8th Cir. 1999), *cert. denied sub nom. Enron Power Mktg., Inc. v. Northern States Power Co.*, 528 U.S. 1182 (2000). There, the court considered the application of Order 888 to certain utilities' systematic preference for their own transmissions over those of their competitors when conditions of system constraint require curtailment of transmissions. *See* Order No. 888 at 31,748-50, 31,923-25, Pet. App. 274a-279a, 325a-330a. The court sustained their power to discriminate. 176 F.3d at 1093.[26]

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[24] Similarly, Texas has refused to connect to the interstate grids precisely to keep "its" substantial excess capacity to itself, preventing the surplus from being used to provide power to other parts of the country experiencing severe shortages. *See* Alexei Barrionuevo & Russell Gold, *Texas May Face a Glut of Electricity, But That Won't Aid Rest of U.S.*, Wall St. J., May 7, 2001, at A1.

[25] The Court has recognized this in considering the problem of curtailment in the context of transportation of natural gas: "The unavoidable conflict between producing States and consuming States will create contradictory regulations that cannot possibly be equitably resolved by the Courts." *LP&L*, 406 U.S. at 633-64.

[26] FERC opposed Enron's petition for a writ of certiorari in that case, No. 99-916, in part on the ground that the matter should await the D.C. Circuit's decision in the present case, and the petition was denied. 528 U.S. 1182 (2000).

Third, and most fundamental, regulation by all of the states that are connected to each interstate grid simply cannot be expected, in the aggregate, to provide workable rules for access to and usage of the grid. As explained above, the physical flow of power occupies the whole grid because every connected user draws physically on every connected supplier. If there are to be rules governing access to and usage of the grid by competing suppliers and competing users, the rules must as a practical matter be the same or compatible for the entire grid. State-by-state regulation is unworkable. *Cf. Healy v. The Beer Inst.*, 491 U.S. 324, 336 (1989) (burden on interstate commerce depends on "how the . . . [state] statute may interact with the legitimate regulatory regimes of other States and what effect would arise if not one, but many or every, State adopted similar legislation"). State regulation could lead to a balkanization of the grids that could impair effectiveness and reliability and thwart both competition and service to users.

In sum, the problem of access to and usage of the grid by the competing power suppliers that have proliferated in the past two decades is beyond the power of the states to police. The FPA, however, clearly provides FERC with the jurisdiction necessary to prevent this undue discrimination in interstate transmission.[27] New York's argument to the contrary would mean that no regulator at all has jurisdiction to address these critical problems.[28]

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[27] FERC's historical jurisdiction over interstate transportation of natural gas played a similarly increased role when new forms of competition led FERC to order open access to natural gas pipelines. *See Associated Gas Distribs. v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied sub nom., Interstate Natural Gas Ass'n of America v. FERC*, 485 U.S. 1006 (1988)).

[28] This Court said in *LP&L*, "[W]hen [the Court is] presented with an attempt by the federal authorities to control a problem that is not, by its very nature, one with which state regulatory commissions can be expected to deal, the conclusion is irresistible that Congress desired regulation by federal authority rather than nonregulation." *LP&L*, 406

Finally, there is no reason to accept New York's argument (NY Br. at 46-48) that FERC regulation of interstate transmission for retail sales will adversely affect maintenance, customer service, and reliability of the grids, and that FERC will set inadequate rates for transmission, creating inadequate incentives for construction of new transmission lines. Contrary to New York's assertions, there is every reason to believe that it is federal, not state, regulation that is needed to improve the grids and make them fully adequate to meet present and future demand. *See* John J. Fialka & Bob Davis, *Cheney Panel Considers Helping Utilities Expand Hydro Power Transmission Lines*, Wall St. J., May 3, 2001, at A2:

> The task force on energy strategy, led by Vice President Dick Cheney . . . is expected to urge [FERC] to boost the rates that utilities can charge customers for transmitting electricity. The higher rates would encourage the construction of new power lines.
>
> * * * *
>
> In the case of electricity transmission, the White House has been looking for ways to unclog the nation's power grid without having the federal

---

U.S. at 641 (quoting *FPC v. Transcon. Gas Pipe Line Corp.*, 365 U.S. 1, 28 (1961)) (internal quotations omitted); *see also id.* at 631 ("[I]n a borderline case where congressional authority is not explicit [, the Court] must ask whether state authority can practicably regulate a given area and, if . . . it cannot, then [the Court is] impelled to decide that federal authority governs.") (internal quotations and citation omitted). In 1935, the Senate Report explained that the purpose of the FPA was to fill not only the "Attleboro gap," but also "[o]ther features of this interstate utility business that are equally immune from State control either legally or practically." S. Rep. No. 74-621, at 17. This Court noted that "Congress' purpose in 1935 was to fill a regulatory gap, not to perpetuate one." *Arkansas Elec.*, 461 U.S. at 384. There is no reason not to interpret the FPA to allow FERC to fill an important gap.

> government string new power lines and build new stations as it once built the interstate highway system.
>
> The White House wants to encourage utilities to speed construction by increasing the regulated return on their investment in new transmission facilities . . . .[29]

At the very least, federal regulators have as strong an incentive as any state regulator to focus on long-range solutions to the problem of energy transmission, rather than on protecting particular groups of users.

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29 In fact, on March 14, 2001, FERC issued an order proposing several initiatives "to protect consumers from supply disruptions . . . [i]n light of the severe electric energy shortages facing California and other areas of the West in recent months." The order also invited comments on, among other things, (1) premiums on equity returns and accelerated depreciation periods for projects that increase transmission capacity, and (2) recovery of a return on non-capital intensive expenditures made to increase transmission capacity on constrained interfaces (e.g., technologies that improve voltage control and power flows). *See Removing Obstacles to Increased Electric Generation and Natural Gas Supply in the Western United States*, 94 F.E.R.C. ¶ 61,272, at 61,967 (2001).

CONCLUSION

The decision of the court of appeals sustaining FERC's orders should be affirmed as to the claims asserted in New York's petition.

Respectfully submitted,

JEFFREY D. WATKISS
BRACEWELL & PATTERSON, L.L.P.
2000 K Street, N.W.
Suite 500
Washington, D.C. 20006
(202) 828-5800

JOSEPH R. HARTSOE
SARAH NOVOSEL
ENRON CORP.
1775 I Street, N.W.
Washington, D.C. 20006
(202) 828-3360

LOUIS R. COHEN
Counsel of Record
JOSEPH E. KILLORY, JR.
JONATHAN J. FRANKEL
IJAY PALANSKY
MICHAEL PLOTNICK
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, D.C. 20037-1420
(202) 663-6000

Counsel for Respondent Enron Power Marketing, Inc.

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IN THE
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PEOPLE OF THE STATE OF NEW YORK AND THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

ENRON POWER MARKETING, INC.,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF RESPONDENT EDISON ELECTRIC INSTITUTE

EDWARD H. COMER
BARBARA A. HINDIN
EDISON ELECTRIC INSTITUTE
701 Pennsylvania Ave., N.W.
Washington, D.C. 20004
(202) 508-5000

CHARLES G. COLE
Counsel of Record
DAVID B. RASKIN
ALICE E. LOUGHRAN
STEPTOE & JOHNSON LLP
1330 Connecticut Ave., N.W.
Washington, D.C. 20036
(202) 429-6270

Counsel for Respondent Edison Electric Institute

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20001

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QUESTIONS PRESENTED

Section 201(b) of the Federal Power Act ("FPA") grants the Federal Regulatory Energy Commission ("FERC") jurisdiction over "the transmission of electric energy in interstate commerce" and "the sale of electric energy at wholesale in interstate commerce" but not over "any other sale of electric energy." The questions presented are:

1. Whether FERC correctly concluded that it has jurisdiction under FPA § 201(b) over interstate transmission service that has been unbundled and sold separately from the sale of electric energy to a retail customer?

2. Whether FERC correctly concluded that it lacks jurisdiction under FPA § 201(b) over interstate transmission provided as part of a sale of electric energy in a single, bundled transaction with a retail customer?

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OPINIONS BELOW

The opinion of the court of appeals is reported at 225 F.3d 667. Pet. App. 3a-121a.[1] The pertinent orders of the Federal Energy Regulatory Commission ("FERC"), Order No. 888 and Order No. 888-A, are reported at 61 Fed. Reg. 21,540 and 62 Fed. Reg. 12,274, respectively. Relevant portions also appear at Pet. App. 125a-369a and 371a-551a.

JURISDICTION

The judgment of the court of appeals was entered on June 30, 2000, and the petitions for rehearing were denied on August 22, 2000. Pet. App. 3a, 123a-124a.

The petitions for a writ of certiorari were filed on October 12, 2000 and November 20, 2000, and were granted on February 26, 2001. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) (1994).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Sections 201(a)-(d), 212(h), and 313(b) of the Federal Power Act of 1935 ("FPA"), 16 U.S.C. §§ 824(a)-(d), 824k(h), 825*l*(b) (1994); and Sections 1(a), (b), and 7(c) of the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717(a), (b), 717f(c) (1994); and 18 C.F.R. § 35.28 (2000) (the open access regulation) are reproduced in relevant part in an appendix to this brief. App., *infra*, 1a-8a.

STATEMENT OF THE CASE

The Nation's electric industry is in transition. Over the past decade, FERC has opened the market for wholesale electric power sales to competition. In addition, in many states, the traditional industry model of a single vertically-integrated firm providing retail service to a customer has

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[1] "Pet. App." refers to the appendix to the petition for a writ of certiorari filed by Enron Power Marketing, Inc. ("Enron") in No. 00-809.

given way to competition for the supply of electric energy to retail customers. In order to permit such competition, states have ordered or permitted utilities to "unbundle" their transmission services—to sell retail transmission service independently of electric energy. FERC's issuance of Order No. 888 was a keystone event in this transition, prescribing uniform rules of access to transmission in wholesale energy markets and in those retail markets in which the states have permitted competition for electric energy.

Respondent Edison Electric Institute ("EEI") submits this brief in support of FERC's decision on the jurisdictional issues in Order No. 888. FERC concluded that it possessed exclusive jurisdiction over interstate transmission service that has been unbundled from a retail sale of energy, but lacked jurisdiction over transmission that was a component of a bundled retail sale. This interpretation has been challenged both for overreaching and for failing to assert jurisdiction granted by Congress.

EEI urges this Court to reject both attacks. Order No. 888 represents a sound construction of the language of the Federal Power Act. Retail transmission sold separately from energy falls within the statutory grant of jurisdiction for "the transmission of electric energy in interstate commerce," while a transmission sold as part of a sale of energy to retail customers falls within its exception for "any other sale of electric energy." 16 U.S.C. § 824(b)(1). This interpretation protects service to retail customers in states that follow the traditional model, while ensuring that competing energy suppliers receive equal access to transmission facilities in states that have opened retail markets to competition. It is well suited to a nation in which different states are following different courses with respect to retail competition.

I. BACKGROUND

A. Edison Electric Institute

EEI is the national association of U.S. shareholder-owned electric companies, their affiliates and industry associates worldwide. Its members are located in forty-nine States and the District of Columbia. EEI's members serve over ninety percent of all customers served by the shareholder-owned segment of the industry. They generate approximately three quarters of all the electricity generated by electric companies and serve about seventy percent of all retail customers in the nation. EEI members own approximately seventy percent of all transmission facilities in the country.

EEI members participate in all aspects of the restructured electric industry. EEI members include companies that provide traditional bundled service under an obligation to serve retail customers and companies operating in states that have adopted retail competition. Some EEI members are vertically integrated, some have separated their generation, transmission and distribution into separate business units or affiliates, and others have divested portions of their electric businesses. All EEI members are public utilities subject to FERC jurisdiction, and they provide open access transmission service over their transmission facilities as required by Order No. 888. Many EEI members participated in the proceedings below and were named as respondents in the petitions for certiorari.

B. Changes in the Retail Electric Industry

When Congress enacted the Federal Power Act in 1935, there was no such thing as unbundled retail transmission service. In 1935 and for many decades thereafter, the vast majority of electric service to consumers was provided by vertically-integrated utility companies subject to state regulation. Pet. App. 28a, 141a. Their service combined generation with delivery of electric power into a single bundled service. Pet. App. 9a, 27a, 141a. The retail

customer had no choice among providers, and the rates, terms and conditions of the delivered service were fully regulated by the States. Pet. App. 28a, 30a. As of this time, many states have retained the traditional model of the franchised utility as the preferred means of providing quality service to their retail customers.

In the past decade, however, a number of states have decided to open their retail markets to competition among energy suppliers. Pet. App. 132a. As a critical first step, they have directed or permitted the utilities in their jurisdiction to provide transmission service independently of energy. This enables other potential suppliers of energy to purchase the transmission service for use in selling their own energy to retail customers. This unbundling of transmission service represents a paradigm shift from the franchised, vertically-integrated utility to a competitive marketplace in which different firms seek to provide different aspects of electric service directly to retail customers. And it has transformed the primary role of regulation from supervising the rates, terms and conditions of bundled service to assuring that competition among energy suppliers for the same retail customers takes place under fair conditions.

C. Changing Uses on The Interstate Grid

The role of the interstate grid has also changed dramatically in recent years. Traditionally, utilities built transmission lines for the benefit of their own customers and with funds supplied by those customers. Pet. App. 28a, 141a. Their principal purpose was to transmit power from nearby sources of generation and within their retail service areas. *Id.* Gradually, utilities began interconnecting their systems permitting the exchange of electric energy in a wholesale market, but until relatively recently these exchanges usually involved transactions between the utilities themselves.

Since the enactment of the Federal Power Act, electric utilities have constructed thousands of miles of high voltage transmission lines linking ("interconnecting") their systems across state lines. Pet. App. 10a, 147a. These interconnections were created to coordinate operations and thereby enhance the reliability of the utilities' systems, as well as to engage in sales of electric energy with each other. *See Gainesville Utils. Dep't v. Florida Power Corp.*, 402 U.S. 515, 520-24 (1971); Pet. App. 10a, 141a, 147a. They were also constructed to enable utilities to participate jointly in large generating projects located at a distance from the utilities' service territories. Pet. App. 147a. Over the past three decades or so, this construction has produced highly integrated regional transmission networks over which electric power flows freely between systems and across state lines. *Id.*

Although the interstate transmission grid consists primarily of transmission lines planned and built by individual utilities, in many respects the grid functions like a reservoir full of water: "a given amount of power enters the system at one point and a like amount is delivered at another point." *Fort Pierce Utils. Auth. v. FERC*, 730 F.2d 778, 782 (D.C. Cir. 1984). The original producer of electrons has no control over them after they enter the transmission grid because they commingle with other electrons from different sources. Even though each increment of production by a given generator expands the supply of energy available to meet demand on the electric system, the electrons added to the interstate grid by a particular generator will not necessarily be those that reach his buyer.

As one petitioner aptly put it in the proceedings below: "electrons do not respect State boundaries."[2] Electrons

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[2] Request of the National Association of Regulatory Utility Commissioners for Rehearing of Order No. 888, at 9 (May 4, 1996) (FERC Docket Nos. RM95-8-00 and RM94-7-001).

follow the laws of physics, rather than contract rights or regulatory law. On the interconnected AC network, electrons disperse onto the various available transmission lines, and electrons seek the path of least electrical resistance under Ohm's law. The configuration of regional generation use, available transmission lines and the location of electrical loads all affect the pattern of flows on the interconnected grid. Thus, such patterns of flow are complicated, dynamic and not necessarily congruent with the contractual path of an identified transaction.[3] Through these multiple, indirect paths, the grid moves energy in bulk quantities over significant distances and from one local area to another.

The "local distribution facilities" of electric utilities are different. These facilities operate at lower voltages and do not transfer large quantities of electricity for long distances across broad geographic regions. Pet. App. 350a-351a, 368a. Rather, utilities own and operate "substations" at which power is received from high voltage transmission lines, voltages are reduced ("stepped down"), and power is then sent into the lower capacity distribution lines for delivery to end-use consumers. Pet. App. 350a-351a, 360a. Distribution facilities typically operate like appendages to the transmission system, with power flowing radially out from the transmission grid to ultimate consumers. As defined by the Commission, local distribution facilities are typically those into which power may enter but from which it does not exit.

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[3] *See* Comments of North Carolina Utilities Commission at 4 n.2 ("[T]he actual path taken by electric power flow across a transmission system is difficult to predict. Because of its interconnection with neighboring systems, a transmission system typically consists of a number of possible paths between any two points. . . [T]he actual flow of electricity typically diverges significantly from the contract path, with the result that the supposed economics of the contract path frequently have little to do with the actual cost of the power transfer.") (Aug. 10, 1995) (Order No. 888 Rulemaking Proceedings, FERC Docket Nos. RM95-8-00 and RM94-7-001).

Pet. App. 36a n.6. Thus, power flows in a distribution facility rarely have a material impact on transmissions of electricity in bulk quantities on the interstate grid.

II. RESTRUCTURING OF THE ELECTRIC INDUSTRY

By the 1970s, some electric industry participants began looking at interstate transmission as a means of enabling them to compete in the supply of electric power at the wholesale level. Pet. App. 10a, 29a. In 1978, as a response to the energy crises of the 1970s, Congress enacted the Public Utilities Regulatory Policy Act, Pub. L. No. 95-617, 92 Stat. 3117 (1978) ("PURPA"). PURPA spawned the development of a new, non-utility generation industry that began demanding access to the interstate transmission grid in order to compete with utility-owned generation.

In 1992, Congress enacted the Energy Policy Act, Pub. L. No. 102-486, 106 Stat. 2776 (1992) (EPAct), which expanded FERC's authority to order utilities to provide interstate transmission service as a separate unbundled product. However, Congress expressly limited this authority to ordering "wholesale" transmission services, thereby preserving to the States the authority to continue regulating bundled retail services, and to choose whether and under what terms competition for retail sales of electric energy might be permitted. To this end, Congress expressly prohibited FERC from ordering wheeling directly to an end-user and prohibited sham transactions designed to circumvent the ban on mandatory retail wheeling. 16 U.S.C. § 824k(h).

A. Order No. 888

By 1995, the competitive market for wholesale power had evolved to the point that FERC perceived a risk that transmission-owning utilities could favor their own merchant activities (*i.e.*, wholesale power transactions) by offering transmission services to competitors on discriminatory

terms. Pet. App. 557a-559a, 566a. In Order No. 888, FERC ordered every transmission-owning public utility subject to its jurisdiction to file an open access transmission tariff with uniform terms and conditions of service under which it would supply transmission both for its own wholesale transactions and for those of its competitors. Pet. App. 133a-134a.

Further, FERC determined that where interstate transmission was provided to retail customers separately from a sale of energy, it would also be subject to the open access tariff, thereby ensuring that such services would be provided on a non-discriminatory basis to competing energy providers. Pet. App. 136a, 305a. However, the Commission did not apply its open access transmission requirements to state-regulated, bundled retail electric sales, which are not supplied in a competitive market. Pet. App. 306a. Rather, consistent with the Energy Policy Act, it respected the right of individual states to decide whether retail services should be unbundled to permit competition for such services and, absent such competition, allowed the states to continue to regulate all components of bundled retail service. Pet. App. 305a-306a.

Even with respect to unbundled retail transmission services, Order No. 888 specifically preserved state jurisdiction over local distribution facilities used to deliver energy to end-users. Pet. App. 282a-283a, 310a-312a. FERC proposed seven physical characteristics that could be used to distinguish such distribution facilities from electric transmission.[4] As a matter of process, FERC said that public

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[4] The seven indicators of local distribution are: (1) close proximity to retail customers; (2) radial design; (3) inflows are common, outflows are rare; (4) power is not reconsigned or transported on to other markets; (5) power is consumed in a comparatively restricted geographical area; (6) meters measure flows at the interface between transmission and local distribution; and (7) distribution systems feature reduced voltage. Pet. App. 282a-283a.

utilities must consult with their state regulatory authorities before petitioning FERC for a ruling on the proposed classification and that FERC would defer to state recommendations on where to draw the line. Pet. App. 312a.[5]

The Commission also addressed in Order No. 888 various issues relating to the rights of different entities to access the grid when transmission capacity is insufficient to handle all of the competing transactions. Pet. App. 264a-274a. It permitted utilities to reserve sufficient transmission capacity on their systems to serve reliably their bundled retail service customers, the so-called "native load." However, it also established requirements concerning the calculation of remaining available transmission capacity ("ATC"), which would be utilized to establish the quantity of capacity available for customers under the open access tariffs. Order No. 888, 61 Fed. Reg. 21,540, 21,574-75 (May 10, 1996); Pet. App. 267a-72a. Further, FERC asserted authority to review such determinations of ATC, including the "set-aside" for bundled retail service (*i.e.*, for "native load"), to ensure that transmission capacity would not be withheld arbitrarily from the open access market. Order No. 888-A, 62 Fed. Reg. 12,274, 12,301 (Mar. 14, 1997); *see also* note 42 *infra*. In addition, once a utility determines that sufficient ATC exists to provide service under the open access regime, the priority rules established in Order No. 888 mandate the same level of "firmness" to open access transmission customers in comparison with bundled retail customers. Pet. App. 269a-270a.

B. Decision of the Court of Appeals

The court of appeals upheld FERC's conclusions with regard to jurisdiction. It agreed with FERC that the definition

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[5] Since the promulgation of the final rule in 1996, FERC has not overruled any state commission recommendation with respect to the extent of local distribution.

of interstate transmission in FPA § 201(c), as construed by this Court's decisions, was broad enough to provide jurisdiction over retail as well as wholesale transmission. Pet. App. 35a. Thus, the court of appeals rejected New York's argument that FERC lacked jurisdiction over unbundled retail transmission.

The court also agreed with FERC that FERC was not required to mandate unbundling and assert jurisdiction over all retail transmissions. "Just as FPA Section 201 gives FERC jurisdiction over transmissions in interstate commerce and sales at wholesale, the statute also clearly contemplates state jurisdiction over local distribution facilities and retail sales." Pet. App. 35a. In the court's view, "[a] regulator could reasonably construe transmissions bundled with generation and delivery services and sold to a consumer for a single charge as either transmission services in interstate commerce or as an integral component of a retail sale." *Id.* The Court upheld FERC's decision to characterize a bundled transmission as part of a retail sale as a "statutorily permissible policy choice." *Id.*

Finally, the court rejected New York's argument that the seven-factor test used for identifying local distribution in the context of retail transmissions should also be used for wholesale transmissions. The court held that the FPA gave FERC jurisdiction over all aspects of a wholesale transmission, regardless of the facility involved. Pet. App. 38a-39a.

C. State Unbundling Following Order No. 888

At the time FERC issued Order No. 888, no state had fully unbundled retail service, permitting competition for retail customers. In a few states, there were limited experiments permitting large customers to seek alternative suppliers. Following Order No. 888, a significant number of states enacted legislation or rules mandating the unbundling of retail

services.[6] All of these states were aware of the jurisdictional implications of Order No. 888, and in some cases specifically referred to it in the retail access legislation.[7] Other states have declined to embrace retail competition, or have chosen to defer its implementation.

SUMMARY OF THE ARGUMENT

Order No. 888 respects the division of federal and state authority drawn by Congress in the FPA, while taking into account the changes that have taken place since the Act was enacted. It protects the legitimate interests of retail customers who depend upon a single utility providing traditional retail service, while ensuring fair access to transmission facilities in those markets where the supply of electricity has become the subject of competition, often on an interstate basis. Because Order No. 888 is soundly based in the language of the FPA and consistent with its objectives, it should be affirmed.

Both sets of challengers proceed on the same core assumption that unbundling is merely an artificial accounting convention and, from that premise, reach opposite conclusions. Both are wrong. Unbundling represents a fundamental change in the way that utilities do business, with important legal and economic implications. From a legal perspective, the unbundling of transmission means that transmission is sold in commercial transactions separate from

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[6] States that have ordered retail competition include: Arizona, Arkansas, California, Connecticut, Delaware, Illinois, Maine, Maryland, Massachusetts, Michigan, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, Pennsylvania, Oklahoma, Oregon, Rhode Island, Texas, and Virginia. Current information about the status of various state retail programs, as well as some corresponding citations, may be found at www.eia.doe.gov/cneaf/electricity/chg_str/tab5rev.html.

[7] *See, e.g.*, Okla. Stat. Ann. Tit. 17 § 190.2; *see also* Brief of Amici Curiae State of California at 1 (admitting that California made its choice regarding retail competition knowing FERC's position on the jurisdictional issue).

the sale of electric energy. From an economic perspective, unbundling is a means of introducing competition into an electric market, and thereby creates a need for rules to prevent discrimination against competitors seeking to enter that market. Order No. 888 recognizes the significance of these distinctions, while reasonably characterizing traditional bundled transmission service as integral to a retail sale of energy and hence outside the Commission's jurisdiction.

New York and its allied petitioners ("New York") question whether retail transmission involves interstate commerce. However, the Commission relied on settled law and universally accepted scientific fact when it posited that retail transmission over the interconnected grid would be "in interstate commerce." 16 U.S.C. §§ 824(b), (c). New York failed to challenge that point before the Commission and failed to raise in the court of appeals the largely factual issues that it presents here. This case must therefore be decided on FERC's premise that its rule was directed at interstate transmission.

FERC's rule accords with FPA § 201(b), which grants federal jurisdiction over interstate transmission without a limitation to wholesale transactions. It therefore encompasses transmission service to retail customers when that service is sold separately from energy. Indeed, this intent is confirmed by the wording of the proviso to § 201(b), which excepts only "any other sale of electric energy." A separate sale of unbundled transmission service is not a "sale of electric energy." 16 U.S.C. § 824(b).

New York relies heavily upon FPA § 201(a), but that declaration of policy does not override the express grants of jurisdiction in the statute. Moreover, by its own terms, § 201(a) does not apply here. At most, this section states an intention to preserve for the States their jurisdiction over matters that they were regulating at the time of enactment. These did not, of course, include interstate transmission

divorced from retail sales. Indeed, "direct" state regulation of interstate transmission independent of a retail transaction would likely have been viewed as unconstitutional. Thus, such jurisdiction was not saved, and certainly was not granted, by § 201(a).

New York quotes extensively from the legislative history of the FPA. To the extent that such history is meaningful at all, it confirms that Congress intended to save for the states their "pre-existing jurisdiction," which involved bundled retail sales. It also shows an intent to have federal jurisdiction fill any gap that was created by constitutional limitations on state jurisdiction over interstate transmission—limitations that were already apparent at the time of enactment. Thus, FERC has acted in conformity with congressional intent when it has assumed jurisdiction over transmission facilities used in the new competitive interstate markets created by state restructuring.

Finally, New York cannot rely on a presumption against federal preemption of the States' traditional police powers. The question of whether FERC has authority over unbundled sales of transmission is not a question of preemption but rather of jurisdiction. Questions of agency jurisdiction are determined by its organic statute, without reference to presumptions. This is especially true with respect to the FPA, which contains its own detailed jurisdictional provisions. Thus, this Court has never referred to presumptions in analyzing those provisions.

Amici California and California Public Service Commission ("California") seek reversal on completely different grounds, contending that all retail transmission falls within § 201(b)'s exemption for "local distribution." This argument is not properly before the Court because it was not presented to the Commission, to the court of appeals or to this Court in the petition for certiorari. In fact, petitioner New York actually endorsed the use of the seven-factor test announced

by the Commission as the means of identifying which facilities are involved in "local distribution."

In any event, FERC's interpretation is faithful to the language of this provision and the governing case law. There would be no point in an exemption for "any other sale" if local distribution covered all retail sales. "Local distribution" has a narrower meaning, consistent with pre-enactment case law that identified "local distribution" as occurring when gas pressure or voltage was reduced for purposes of retail delivery. Post-enactment case law has confirmed that the identification of "local distribution" facilities is a question of fact to be decided by the Commission. The Commission's use of a seven-factor test to identify such facilities has not been shown to be arbitrary or capricious. Thus, this exception does not remove all retail transmission from FERC's jurisdiction.

Enron, seeking federal jurisdiction over transmission for bundled retail sales, contends that § 201(b) of the FPA "gives FERC jurisdiction, without any stated limitation or qualification, over all interstate transmissions of electric energy." Brief of Enron in No. 00-809 ("Enron Br.") at 21. This argument, however, ignores both the "any other sale" proviso of § 201(b)—specifically excluding retail sales of power from FERC jurisdiction—and the six decades of history leaving to the States jurisdiction over any transmission sold as part of the retail power sale. Congress has amended the FPA on several occasions, but has not altered this allocation of responsibility.

Enron relies for support almost exclusively on case law under the Natural Gas Act. This case law is not dispositive, since the natural gas industry developed along different lines than the electric industry. From the outset, natural gas was transported by interstate pipelines owned by different companies than were responsible for production and distribution. Congress sought to place this separate interstate

transportation function under federal control by adopting a certification requirement in § 7(c) of the NGA, which has no counterpart in the FPA. In order to give effect to the Commission's powers under § 7(c), the courts adopted a broad construction of the jurisdictional provisions of the NGA, giving the Federal Power Commission ("FPC") authority to regulate transportation in connection with direct industrial sales.

The natural gas cases, which are rooted in the history and structure of the NGA, do not establish that FERC's interpretation of the FPA was unreasonable. The FPA has its own distinctive history, which has left the regulation of all aspects of bundled retail sales to the States. In this light, it was reasonable for FERC to conclude that transmissions bundled with retail sales are outside of its jurisdiction. FERC's reasonable interpretation deserves judicial deference.

Finally, Enron makes a policy argument that FERC jurisdiction over bundled retail sales is needed to combat discrimination by transmission-owning utilities against their competitors. However, Enron fails to acknowledge that, in states where only bundled service is provided, there is no competition for retail customers. Moreover, there is no discrimination when a utility with an obligation to serve reserves transmission capacity to serve its native load customers. Insofar as Enron and its *amici* are complaining that some utilities may have over-reserved capacity, FERC has authority under Order No. 888 to review and remedy such abuses.

ARGUMENT

I. FERC LAWFULLY ASSUMED JURISDICTION OVER UNBUNDLED INTERSTATE TRANSMISSION SERVICE PROVIDED TO RETAIL CUSTOMERS.

The Commission's conclusion that it had jurisdiction over the transmission component of an unbundled retail sale rests

directly on the language of the Federal Power Act. Its reasoning proceeds in two simple steps.

First, the Commission has jurisdiction over the transmission of electricity in interstate commerce. Transmission of electric energy to retail customers over the interconnected grid is interstate. Thus, unless a specific exception within the statute prevents the Commission from exercising that jurisdiction, the Commission has power to regulate such transmission.

Second, there is no exception in the language of § 201 that would prevent the Commission from assuming jurisdiction over interstate transmission that is unbundled from a retail sale. To be sure, the Commission does not have jurisdiction over a retail "sale of electric energy" under the proviso of § 201(b). However, the separate sale of transmission service is *not* a sale of electric energy and hence does not fall within this exception. Thus, the Commission has soundly concluded that it has jurisdiction over all forms of unbundled, interstate transmission.

A. The Rule Properly Applies to Transmission in Interstate Commerce.

As the court of appeals pointed out, "[b]oth FPA § 201(a) and (b) clearly and unambiguously confer upon FERC jurisdiction over the 'transmission of electric energy in interstate commerce.'" Pet. App. 32a. Consistent with these provisions, in Order No. 888, the Commission applied its rule only to "the transmission of electric energy in interstate commerce . . . ." 18 C.F.R. § 35.28(c)(2) (2000). In the course of the rulemaking proceeding, moreover, the Commission explained that retail transmission on the interconnected grid generally falls within this phrase:

> The term does not turn on whether the contract path for a particular power or transmission sale crosses state lines, but rather follows the physical flow of electricity. Because of the highly integrated nature of the electric

> system, this results in most transmission of electric energy being "in interstate commerce."

Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Notice of Proposed Rulemaking, 59 Fed. Reg. 35,274, 35,284 (July 11, 1994). The only exceptions, the Commission later noted, were the purely intrastate transmission systems in Alaska, Hawaii and an isolated portion of Texas. Pet. App. 305a n.541.

The Commission had no need to say more regarding the scope of interstate transmission since it was already settled, both as a matter of law and of fact, that transmission on the interconnected grid was interstate in nature. This Court had repeatedly held that transmission was interstate if any portion of the electrons involved in the transmission originated out of state or departed for another state. *E.g., FPC v. Florida Power & Light Co.*, 404 U.S. 453, 463 (1972); *Connecticut Light & Power Co. v. FPC*, 324 U.S. 515, 529 (1945) ("Federal jurisdiction was to follow the flow of electric energy, an engineering and scientific, rather than a legalistic or governmental, test."). It was also consistent with the Commission's technical understanding that electrons on an interconnected grid do not move in conformity with contractual arrangements, but rather follow the path of least resistance.[8] Thus, the Commission assumed that a rule directed at the "transmission of electric energy in interstate commerce" would necessarily encompass retail transmissions on the interconnected grid.

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[8] *See* Pet. App. 612a n.144 ("[I]n reality power flows are rarely confined to a designated contract path . . . . [T]he laws of physics . . . cause power . . . to travel along multiple parallel paths and divide itself among those paths along the lines of least resistance.") (citation and quotations omitted).

New York now apparently seeks to challenge that view.[9] It argues that such retail transmission must be intrastate because "most retail electricity transactions involve generators and consumers that are not only in the same state, but in proximity." Brief of New York in No. 00-568 ("NY Br.") at 37. Then it offers an interpretation of § 201(c) that transmissions are not interstate if they are between buyers and sellers in the same state. *Id.*

To the extent that the generalizations in the Commission's preambles are reviewable at all,[10] New York has failed to present its contentions in a timely fashion. New York failed to challenge the factual adequacy of the rulemaking record in any of the proceedings below. It did not argue before the Commission that the record lacked substantial evidence to support the premise that retail transmission over the interconnected grid could be "in interstate commerce." Nor did it make that contention in the court of appeals.

Under these circumstances, New York has waived the attack it presses here. Under § 313(b) of the Federal Power Act, New York was required to raise that issue before the Commission in its petition for rehearing prior to court review. 16 U.S.C. § 825*l*(b) ("No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the

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[9] New York's presentation of this issue is, at best, equivocal. The question in its petition referred to "transmission of energy from generators to retail customers *in the same state*" and to "intrastate" retail transmission, New York Pet. for Cert. at i. However, the question in New York's merits brief does not have either reference. Brief of New York in No. 00-568, at i.

[10] *See Kennecott Utah Copper Corp. v. U.S. Dep't of Interior*, 88 F.3d 1191, 1223 (D.C. Cir. 1996) (preamble reviewable only where it has "independent legal effect, which in turn is a function of the agency's intention to bind either itself or regulated parties."); *Florida Power & Light Co. v. EPA*, 145 F.3d 1414, 1418-20 (D.C. Cir. 1998) (denying review of preamble).

application for rehearing unless there is reasonable ground for failure so to do."). *See City of Orville v. FERC*, 147 F.3d 979, 990 & n.13 (D.C. Cir. 1998); *Gulf States Utils. Co. v. FERC*, 1 F.3d 288, 291-92 (5th Cir. 1993); *cf. FPC v. Colorado Interstate Gas Co.*, 348 U.S. 492, 498-99 (1955) (construing analogous provision in § 19(b) of the Natural Gas Act).[11]

New York's failure to raise its issue as to the scope of "in interstate commerce" before the Commission makes it impossible, as a practical matter, for courts to undertake judicial review of that issue. In its two briefs, New York has relied entirely on materials outside of the rulemaking record. *See* NY Br. at 45 n.28; Brief of New York as Respondents in No. 00-809 ("NY Resp. Br.") at 25-26. Neither the Commission nor the other parties to the rulemaking had any opportunity to address New York's points in that context through factual material or otherwise. This is not the forum in which to begin a scientific debate as to the flow of electrons on the interstate grid. In fact, in interpreting parallel statutory language, this Court has ruled that when a party fails to present its issue to the Commission, the court of appeals may not even decide it *sua sponte*. *FPC v. Colorado Interstate Gas Co.*, 348 U.S. at 498-99.

In any event, there is no merit to New York's position. The salient principle of *FPC v. Florida Power & Light Co.*, 404 U.S. 453 (1972), is that the potential for commingling of electrons among interconnected systems is sufficient to demonstrate the interstate nature of the transmissions. The Court did not limit the scope of its holding to accounting

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[11] Even in the court of appeals, New York did not raise the largely factual issues that it is raising now. On the contrary, it acknowledged in that court that "[t]he issue here is a question of law." Brief of Petitioners/Intervenors Public Service Commissions of New York and Florida, *et al.*, at 11 n.14 (Aug. 19, 1999), *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000) (No. 97-1715).

requirements, and no court has construed it as such. *See, e.g., FERC v. Mississippi*, 456 U.S. 742, 757 (1982). Subsequent cases have consistently observed that it is impossible to know the source or destination of individual electrons, and have therefore accepted that transmission over the grid involves interstate commerce. *E.g., Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 381 (1983); *New England Power Co. v. New Hampshire*, 455 U.S. 331, 336 (1982).

Here, New York asserts that retail customers receive most of their energy from the nearest power plant, but does not purport to show that generation from other sources plays no part in serving them. Indeed, New York acknowledges as "arguably accurate" the assumption that all transactions affect the entire grid and admits it is "technically correct" that electrons added to the grid will travel throughout. NY Resp. Br. at 25. Yet this Court has held that the amount of electricity flowing in interstate commerce is irrelevant. *Connecticut Light & Power*, 324 U.S. at 536; *Florida Power & Light*, 404 U.S. at 463. Thus, the admitted possibility that electrons flowed into or out of the state is a sufficient basis to find transmission "in interstate commerce."

New York's argument is ultimately based on a mistaken interpretation of FPA § 201(c). In its view, that subsection "states that transmissions are *not* interstate if they are between buyers and sellers in the same state." NY Br. at 37. But this provision does not refer to "buyers" and "sellers" at all: "For the purpose of this subchapter, electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof . . . ." 16 U.S.C. § 824(c). In view of the interconnected nature of the grid and the multiple, non-contractual paths followed by power flows, the Commission could reasonably find that some of the electrons reaching a retail buyer of electric power

originated outside of the buyer's state.[12] Thus, this case must be decided on the Commission's premise that transmission service for unbundled retail sales on the interstate grid involves "the transmission of electric energy in interstate commerce." 16 U.S.C. § 824(b).

B. Transmission Unbundled From a Retail Sale Does Not Fall Within Any of the Exceptions to Section 201(b).

The grant of jurisdiction in FPA § 201(b) for transmission in interstate commerce is not limited by any exception that would preclude FERC from asserting jurisdiction over unbundled retail transmission. FERC found, and the court of appeals agreed, that this grant was not limited to transmission in the course of wholesale transactions. Pet. App. 34a, 305a, 333a. FERC observed that § 201(b) contained two separate grants of jurisdiction that differed in scope—one for the "transmission of electric energy in interstate commerce" and the other for "the sale of electric energy at wholesale in interstate commerce." Pet. App. 333a; *see also* Pet. App. 305a. The first grant for interstate transmission stands in contrast to the second, which the statute specifically limits to

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[12] Moreover, the distinction between "intrastate" and "interstate" transmission proposed by New York based on its interpretation of FPA § 201(c) is unworkable. Under current retail access programs, electric suppliers do not typically identify the source of their power by reference to a particular generating plant. Rather, they typically acquire a portfolio of generating resources that they can use to supply their overall load requirements. These portfolios include contracts for system power and contracts with other marketers that are selling out of their own portfolios. In many areas of the country, moreover, utilities have formed multi-state power pools in which sources of supply are centrally sold and purchased on a regional basis without identification of generation sources to individual states. In short, New York has not explained how it would even be possible to implement the proposed distinction between interstate and intrastate transmission transactions under its interpretation of § 201(c).

sales "at wholesale." This omission of the reference to "at wholesale" strongly indicates an intent not to limit FERC's jurisdiction over transmission service to wholesale transactions.

This intent is underlined by the one portion of § 201(b) specifically addressing retail transactions. Section 201(b) not only grants jurisdiction over wholesale transactions, but denies any federal jurisdiction over retail sales of electric energy: "The provisions of this subchapter . . . shall not apply to any other sale of electric energy. . . ." 16 U.S.C. § 824(b). The language of this proviso plainly pertains to a sale *of electric energy*. It is this form of retail transaction that is placed outside the Commission's jurisdiction. The proviso by its express terms does not apply to a sale of *transmission service*.

New York cannot turn a sale of unbundled transmission service into a sale of energy by calling unbundling a mere accounting convention. *See, e.g.*, NY Br. at 8 ("Unbundling is a change in bill format."). The heart of unbundling is that each service may be purchased without the other, enabling competition.[13] When transmission is unbundled, it is available from the transmission owner without purchasing its energy at all.[14] Thus, the furnishing of unbundled transmission service is not a "sale of electric energy" within the proviso to § 201(b).

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[13] *See, e.g.*, Conn. Gen. Stat. §§ 16-244b, 244e ("All customers of electric distribution companies . . . shall have the opportunity to purchase electric generation services from their choice of electric suppliers . . . in a competitive generation market . . . ."); Del. Code Ann. Tit. 26 § 1003; Me. Rev. Stat. Ann. Tit. 35-A § 3202; Okla. Stat. Ann. Tit. 17 § 190.4; Va. Code Ann. § 56-577. *Cf. Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 284 (1997) (describing unbundling of natural gas).

[14] New York admits, "Unbundling . . . allows customers the option of obtaining one or more retail service elements from competitive providers, instead of the utility." NY Br. at 9 (footnote omitted).

Rather than discuss this operative language, however, New York discusses at length the declaration of policy in FPA § 201(a). In essence, New York would have this Court avoid the plain language of § 201(b) by interpreting § 201(a) as imposing an "at wholesale" qualification to the "transmission of electric energy" language. This effort at reconstruction of the statute should be rejected.

First, FPA § 201(a) is a declaration of policy, not a substantive provision of the statute. *See* 16 U.S.C. § 824(a) ("It is declared that . . . ."). Thus, this Court's cases have consistently held that § 201(a) cannot trump specific language in § 201(b). *See Connecticut Light & Power*, 324 U.S. at 527 (holding § 201(a) "cannot nullify a clear and specific grant of jurisdiction, even if the particular grant seems inconsistent with the broadly expressed purpose."); *FPC v. Southern Cal. Edison Co.*, 376 U.S. 205, 215 (1964).

Second, even viewing § 201 as a saving clause, it does not provide the States with jurisdiction over a new service like unbundled retail transmission. Section 201(a) of the FPA states in pertinent part that "Federal regulation . . . [is] to extend only to those matters which are not subject to regulation by the States." 16 U.S.C. § 824(a). At most this suggests that the States would continue to regulate those matters that they were then regulating. Interstate transmission unbundled from a retail sale of energy was not among the transactions regulated by the States in 1935 and therefore was not "saved" by this provision. *See Knickerbocker Ice Co. v. Stewart*, 253 U.S. 149, 162 (1920) ("[t]he usual function of a saving clause is to preserve something from immediate interference—not to create"); *Gorbach v. Reno*, 219 F.3d 1087, 1094 (9th Cir. 2000) (*en banc*) ("Under the saving clause, what authority the Attorney General has, she keeps, but it does not give her more.").

Even taking the most aggressive interpretation of FPA § 201(a)—that it reflected a policy of giving the States

jurisdiction over any area that they *could* regulate—it would not have encompassed unbundled interstate transmission. The scope of what Congress believed the States could regulate would be measured by the relevant constitutional law that existed at the time of enactment. *See FPC v. East Ohio Gas Co.*, 338 U.S. 464, 472 (1950) ("*[P]rior* constitutional decisions, not what we have since decided or would decide today, form the measure of the gap which Congress intended to close by this Act."); *Phillips Petroleum Co. v. State of Wisconsin*, 347 U.S. 672, 684 (1954). In 1935, state regulation of interstate transmission distinct from a sale of electric power would have been viewed as a "direct" regulation of interstate commerce, and hence impermissible under the dormant Commerce Clause.

Mill Creek Coal & Coke Co. v. Public Service Commission, 100 S.E. 557 (W. Va. 1919), a case later cited by this Court in *Attleboro*, illustrates this point. *Mill Creek Coal* involved a Virginia hydro-electric company selling electric power directly to consumers in West Virginia. *Id.* at 560-61. The court stressed the distinction between the sale of electric power and the independent sale of transmission: "The vital distinction should be noted between regulation of rates of transportation and of the rates at which a commodity shall be sold." *Id.* at 562. The court recognized that rates of transportation invoked matters of "national importance requiring uniformity of regulation respecting the rates thereof, and hence [are] usually beyond the regulatory power of the state." *Id.* Nevertheless, when transmission is sold to the retail customer as part of the price of the commodity, the state's regulatory interests are elevated: "The price at which a commodity is sold is essentially local, affecting chiefly those in the community where it is made, and only incidentally, if at all, touching those outside of the

community." *Id.* Thus, the court held, the sale of the delivered commodity was subject to state regulation.[15]

This Court's precedents just prior to passage of the FPA reflect the same thinking. Thus, in *Public Utilities Commission of Rhode Island v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927), this Court cited *Mill Creek Coal* for the concept that "transmission of electric current from one state to another, like that of gas, is interstate commerce." *Attleboro*, 273 U.S. at 86. The Court reasoned that state regulation of an interstate wholesale sale of electricity was impermissible as a "direct burden upon interstate commerce." *Id.* at 89.[16] Thus, under the law at the time of enactment of the FPA, transmission unbundled from a retail sale would likely have been viewed as outside the states' regulatory power, since such state regulation would have been viewed as a "direct" rather than incidental burden on interstate commerce.

In view of this state of the law at the time of enactment, the policy declaration in § 201(a) would not help New York's case. The states never exercised authority to regulate the

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[15] *Mill Creek Coal*'s reasoning is consistent with the Court's existing precedents holding that the direct regulation of transportation between States fell within the exclusive power of the federal government. *See South Covington & Cincinnati St. Ry. v. City of Covington*, 235 U.S. 537, 545-48 (1915); *Wabash St. L. & P. Ry. v. State of Illinois*, 118 U.S. 557, 573-77 (1886).

[16] On the other hand, the interstate transmission involved in the bundled transaction in *Pennsylvania Gas Co. v. Public Service Commission*, 252 U.S. 23 (1920), was viewed as distinguishable on the ground that it was part of the "furnishing of gas" to local consumers. *Attleboro*, 273 U.S. at 87-88. "In holding that the New York Public Service Commission might regulate the rate charged to these consumers, the court said that while a state may not 'directly' regulate or burden interstate commerce, it may in some instances, until the subject matter is regulated by Congress, pass laws 'indirectly' affecting such commerce, when needed to protect or regulate matters of local interest . . . ." *Id.* at 87.

transmission sold independently of the sale of electricity and could not have done so if they tried. New York's effort to invoke the declaration of policy to achieve an *expanding* reservation of jurisdiction to the states runs counter to this Court's precedents interpreting the FPA, which have insisted that the lines drawn by that statute do not change in light of evolving constitutional standards. *Arkansas Elec. Coop. Corp.*, 461 U.S. at 380; *Southern California Edison*, 376 U.S. at 213-17. The policy declaration in § 201(a) does not override the specific grant of jurisdiction over interstate transmission.

C. The Legislative History Does Not Contradict The Plain Language Used In the Statute.

New York emphasizes various forms of legislative history as an antidote to the statutory language. It cites snippets from hearings, debates, and committee reports, as well as subsequent legislative history and litigation positions. Such legislative history is not relevant in the interpretation of an unambiguous statute.[17] Congress has granted jurisdiction over transmission in interstate commerce, except where that function is an inseparable part of a direct sale of electric energy. No resort to the legislative history is necessary or appropriate.

Even if resort to legislative history were permissible, however, *this* legislative history would not be of any assistance. In Order No. 888, FERC was addressing a new phenomenon—unbundled transmission at the retail level—which did not exist at the time of enactment of the FPA. No one in Congress in 1935 could have formed or expressed an intent as to how this new product should be handled, and no

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[17] *Davis v. Michigan Dep't of the Treasury*, 489 U.S. 803, 808 n.3 (1989) ("Legislative history is irrelevant to the interpretation of an unambiguous statute."); *Russello v. United States*, 464 U.S. 16, 23 (1983); *United States v. Oregon*, 366 U.S. 643, 648 (1961).

one did. Thus, even some of the parties signing the New York brief told the Commission that the legislative history is inconclusive.[18] The Commission concluded that the legislative history did not speak directly to the issue at hand. *See* Open Access NOPR, 60 Fed. Reg. 17,662, 17,713 (Apr. 7, 1995).

In fact, the legislative history provides at least as much support for the Commission's interpretation of the statute as for that urged by petitioners. In the first place, as New York itself points out, legislators were concerned that "Congress might inadvertently empower FERC to preempt *pre-existing* state regulation." NY Br. at 20 (emphasis added). *See also* NY Br. at 23 ("The Reports repeatedly stated that the proposed legislation safeguarded all aspects *of pre-existing* state regulation.") (emphasis added); NY Br. at 28, *quoting* FPC Commissioner Seavey ("everything is left to the state commissions that they are performing now"). Such pre-existing state regulation encompassed only the regulation of bundled retail sales, which FERC has preserved.

Second, New York cites several statements in the legislative history suggesting that Congress did not intend to confer FERC jurisdiction over retail sales. NY Br. at 21. As noted earlier, however, this intent is effectuated by the language of FPA § 201(b), which prohibits federal authority over "any other sale of electric energy"—language that does not address interstate transmission sold independently of electric energy. Similarly, California points to various statements indicating that Congress intended to "adopt" this

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[18] *See* Request of the National Association of Regulatory Utility Commissioners for Rehearing of Order No. 888, at 5 ("we agree that the legislative history is not helpful in resolving this jurisdictional question") (May 24, 1996) (FERC Docket Nos. RM95-8-00 and RM94-7-001); Request of the Staff of the Virginia State Corporation Commission for Rehearing of Order No. 888, at 4 ("The legislative history of the FPA does not resolve this jurisdictional question . . . .") (May 23, 1996) (FERC Docket Nos RM95-8-00 and RM94-7-001).

Court's decision in *Pennsylvania Gas Co. v. Public Service Commission*, 252 U.S. 23 (1920). Calif. Br. at 8-11. But the heart of that case was a sale of delivered (*i.e.*, bundled) electricity to the retail customer. Thus, even Solicitor DeVane's statement, as quoted by California, reveals the necessity for a sale as a predicate for jurisdiction under the retail sale proviso. *See* Calif. Br. at 10-11 ("This bill does not give the Commission jurisdiction over *energy* that is transmitted in interstate commerce by a particular company and *sold by that company* to consumers.") (emphasis added). These and other statements regarding "rates" for retail sales must be read in their historical context, when all retail sales involved bundled delivery of energy.

Third, the states are not helped by legislative history indicating that Congress was seeking to fill the jurisdictional void left by this Court's *Attleboro* decision. That history may illuminate the distinction drawn in the statute between wholesale transactions in interstate commerce and "any other sale of electric energy," but it does not explain Congress' enactment of a separate head of jurisdiction for "transmission of electric energy in interstate commerce. . . ." 16 U.S.C. § 824(b). Even in 1935, Congress was aware of an increasing amount of interstate transmission that would not be subject to state regulation. *See* 79 Cong. Rec. 10,352, 10,377 (June 28, 1935) (volume of interstate transmission was "constantly growing and will increase indefinitely in time and amount.") (statement of Rep. Lea). Thus, the legislation was worded "to make plain that it includes interstate transmission where there is no sale . . . ." S. Rep. No. 74-621, at 19 (1935).

Indeed, even though *Attleboro* involved a wholesale transaction, it cited *Mill Creek Coal* for the proposition that the transmission of energy across state lines was interstate commerce. As noted above, state regulation of interstate transmission in the absence of a retail sale of energy would have been problematic under the Commerce Clause. *Cf. Mill Creek Coal*, 100 S.E. at 562 ("Because of the very nature of

the subject-matter conflicting state regulations respecting [transmission] rates ordinarily would result in discord and chaos."). Congress knew of the "comparatively recent transformation [of the electric industry] from an industry of a purely local character to one of a dual local and national character."[19] There was thus good reason for Congress to make a separate provision for federal authority over the transmission of electric energy in interstate commerce.

This grant becomes particularly relevant when states restructure retail service for competition and thereby permit participation by energy suppliers in an interstate market. Out-of-state generators competing for those retail customers need equal access to transmission in order to provide competitive service. Yet individual states are not well situated to regulate unbundled interstate transmission. Once a state's retail markets are opened to out-of-state competition, its interests as a regulator of the incumbent utility may conflict with those of other states whose generators are interested in serving those same retail customers. *See Arkansas Elec. Coop. Corp.*, 461 U.S. at 377 ("[T]he production and transmission of energy is an activity particularly likely to affect more than one State, and its effect on interstate commerce is often significant enough that uncontrolled regulation by the States can patently interfere with broader national interests."). Thus, when a state chooses to unbundle retail service and opens its doors to retail competition, the FPA permits the transmission network to be managed on a regional or national level.[20]

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[19] *Public Utility Holding Act of 1935: Hearings on S. 1725 Before the Senate Comm. on Interstate Commerce*, 74th Cong. 797 (1935) (Memorandum of Oswald Ryan, FPC General Counsel, and Dozier A. DeVane, FPC Solicitor).

[20] *Cf. Gulf States Utils. Co. v. FPC*, 411 U.S. 747, 758 (1973) (a primary purpose of the FPA was to "provide effective federal regulation of the expanding business of transmitting and selling electric power in interstate commerce."); *Appalachian Power Co. v. Pub. Serv. Comm'n. of West Virginia*, 812 F.2d 898, 904-05 (4th Cir. 1987).

D. New York Cannot Defeat the Language of the Statute By Reliance On Presumptions Regarding Preemption.

Finally, New York cannot defeat federal jurisdiction over unbundled retail transmission by invoking a presumption against federal preemption of traditional state powers. *See* NY Br. at 13-17. Preemption analysis focuses on the impact of a defined federal regulatory scheme on state laws in the same or a related field.[21] Here, the preemptive effect of the federal scheme is clear: if FERC has jurisdiction of a form of transmission, that jurisdiction is exclusive. *See Mississippi Power & Light Co. v. Mississippi*, 487 U.S. 354, 377 (1988) (Scalia, J., concurring) ("It is common ground that if FERC has jurisdiction over a subject, the States cannot have jurisdiction over the same subject."). Thus, the question here is not what provision Congress has made for preemption, but what jurisdiction Congress granted in the first instance in the agency's organic statute. None of the cases cited by New York for its presumption deal with jurisdictional questions of that kind, and this Court has not applied that presumption in interpreting grants of authority to federal agencies.[22]

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[21] Thus, in each of the classic preemption cases cited by New York, it was not the scope of the federal officials' power to which the presumption was applied, but rather to the question whether concurrent state regulation was displaced. *See, e.g., Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947) (Federal Warehouse Act preemptive of similar state regulation); *Jones v. Rath Packing Co.*, 430 U.S. 519 (1977) (whether Federal Meat Inspection Act displaces state labeling law); *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504 (1992) (whether federal tobacco labeling requirement preempts state tort action).

[22] *Cf. Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735, 743-44 (1996) (finding presumptions against preemption do not apply to issues concerning the substantive meaning of statutes, even if one proposed meaning results in greater preemption than another).

This is categorically true with respect to the Federal Power Act. In FPA § 201, Congress provided specific instructions as to the scope of federal jurisdiction.[23] While this Court has analyzed the scope of that section at least nine times, *not a single one* of this Court's decisions has relied on a presumption in favor of state police powers as a tool in that analysis. In each case, the Court has approached the statute based on its own terms, rather than an exogenous assumption about congressional intent to preempt.

In any event, federal jurisdiction over unbundled interstate transmission does not involve an encroachment on the State's traditional police powers. The States have *never* regulated (and most likely could not regulate) interstate transmission severed from the sale of electricity. The presumption against federal preemption cited by New York has no role with respect to this new service and the new interstate markets in which it will be offered.

Finally, FERC's interpretation of § 201(b) does not leave the States without authority over matters of primarily local concern. New York does not articulate, and it is difficult to conceptualize, how the Commission's jurisdictional decision has harmed these petitioners. Even where states have introduced competition, they nevertheless retain jurisdiction over all retail energy sales, all local distribution facilities (whose extent will be based on their own recommendations); all transactions of municipalities; and over all generation and transmission siting. Moreover, it is only where states have, subsequent to Order No. 888, chosen to restructure their retail markets that retail transmission would fall under federal jurisdiction. Order No. 888 does not intrude unduly into local matters or significantly alter the federal-state balance.

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[23] *Cf. Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 376 n.5 (1986) (Communications Act "presents its own specific instructions regarding the correct approach to the statute").

E. All Retail Transmission Does Not Fall Under The Exception for Local Distribution.

Amicus California presses for reversal on a completely different ground than that urged by New York. California acknowledges that § 201(b) confers FERC jurisdiction over interstate transmission, but it argues that all retail transmission is exempt from FERC regulation under the exception for "local distribution" facilities in § 201(b). In Order No. 888, FERC interpreted the "local distribution" proviso and adopted a fact-based, seven-factor test for determining whether a facility functions primarily as a local distribution facility subject to state jurisdiction. Pet. App. 282a-283a. California now effectively attacks the validity of that test, arguing that all unbundled retail transmission constitutes "local distribution" under § 201(b).

California's argument is not properly before this Court. California did not appear as either a party or an amicus in the proceedings below. Petitioner New York did not present California's issue before FERC[24] and did not attack the seven-factor test at all before the court of appeals. On the contrary, in the court of appeals, New York *endorsed* the seven-factor test as a means of defining "local distribution" and argued that it should be applied to wholesale transactions as well as retail ones.[25] The court of appeals addressed and

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[24] The argument made by California is barred by FPA § 313(b) because it was never presented to the Commission in a petition for rehearing by a party in these proceedings. Before FERC, New York argued that only two of the seven factors should be used to identify local distribution in large metropolitan and remote rural areas. New York Motion for Rehearing of Order No. 888, at 18-19 (May 24, 1996) (FERC Docket Nos. RM95-8-00 and RM94-7-001). New York did not pursue this challenge in the court of appeals.

[25] *See* Brief of Petitioners/Intervenors Public Service Commissions of New York and Florida, *et al.*, at 31 (Aug. 19, 1999), *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000) (No. 97-1715) ("The seven-indicator test established in FERC Order 888

rejected this complaint. Pet. App. 37a-39a. New York then raised its effort to expand the use of the seven-factor test in its petition for certiorari to this Court, but even this issue regarding local distribution was not accepted for review. In these circumstances, California, as amicus, cannot introduce before this Court a completely different attack on the Commission's rulemaking that has never been presented to any tribunal in the proceedings below.[26]

In any event, FERC's reading is faithful to the statutory text, giving meaning to all of the proviso's language. The phrase "facilities used in local distribution" delineates an exception to the Commission's jurisdiction over facilities used for jurisdictional transmission and sales. California's reading would make redundant the exception for "any other sales of electric power," since, in its view, all aspects of retail sales, including unbundled transmission, fall within the exception for local distribution. Yet § 201(b) identifies "local distribution" as a *separate* exception. Congress presumably intended it to have a separate, more narrow meaning than the retail sales proviso.

That meaning is apparent upon examination of the case law available to the Congress that enacted the FPA. This Court had held in *East Ohio Gas Co. v. Tax Comm'n of Ohio*, 283 U.S. 465 (1931), that interstate movement of natural gas had ended, for tax purposes, when it was stepped down in pressure and divided into the many small service lines that connected with the pipes on the consumers' premises. This

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represents FERC's current judgment as to what constitutes local distribution, and should be applied in all instances to define the local distribution facilities subject to state regulation rather than federal.") (footnote omitted).

[26] This Court will not consider an argument advanced by amicus when it was not raised or passed on below and is not advanced in this Court by the party on whose behalf the argument is being raised. *See United Parcel Serv., Inc. v. Mitchell*, 451 U.S. 56, 60 n.2 (1981).

was viewed as analogous to the "breaking of an original package." *Id.* at 471. Thus, "local distribution" did not refer to an entire "retail sale" but to the point in the process of delivery where interstate shipment was thought to end. *Id.* at 472.

This doctrine was promptly applied to the distribution of electric power. "While electric current can hardly be said to 'come to rest' within the state, its interstate journey ends at the transformer which uses it for the production of low voltage currents for use within the state. The situation is the same in principle as the breaking up of an original package . . . ." *South Carolina Power Co. v. South Carolina Tax Comm'n*, 52 F.2d 515, 525 (E.D.S.C. 1931) (cited in the 1935 Senate Hearings at 802), *aff'd*, 286 U.S. 525 (1932).

Shortly thereafter, Congress enacted the FPA, with its language exempting "local distribution" facilities in § 201(b). In *Connecticut Light & Power Co. v. FPC*, 324 U.S. 515 (1945), this Court confirmed that this phrase would be interpreted consistently with the basic standard of *East Ohio Gas*, but adapted to fit the peculiarities of electrical transmission. The question there was whether facilities used to "step down" the voltage were local distribution facilities. The Court found that its prior holding that "distributing gas at low pressure to consumers is a local business" did not address the question whether "the process of reducing energy from high to low voltage in subdividing it to serve ultimate customers" was also "local distribution." *Id.* at 534. Thus, the Court remanded this issue to the Commission for what was viewed as a factual determination.[27] The Court never adopted any holding that all retail sales were covered by the local distribution exemption.

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[27] *See Connecticut Light & Power*, 324 U.S. at 534-35 ("It is not for us to make an original appraisal of the facts. We do not therefore undertake to decide as an original matter whether the facilities in question are or are not facilities which can subject the Company to the act.").

Again in *FPC v. Southern California Edison Co.*, 376 U.S. 205, 210 n.6 (1964), this Court observed that whether facilities are used in local distribution "involves a question of fact to be decided by the FPC as an original matter." There, the Court sustained the Commission's finding that certain retail sales at high voltage to industrial customers were not local distribution. With support in the record, the Court reasoned, "the conclusion may properly rest upon the specialized experience of the FPC in determining such questions." *Id.* at 210. Other decisions of this Court have similarly treated the phrase "local distribution facilities" as determined by the physical characteristics of the electrical or gas lines, rather than the presence of a retail transaction.[28]

Thus, FERC acted well within existing precedent when it promulgated a rule seeking to define "local distribution" based on the physical characteristics of the facilities, such as the voltage and the role of the lines in directing energy to an end use. *See* note 4, *supra*. Neither *amicus* California nor any party has shown that rule to be arbitrary and capricious. Thus, unbundled retail transmissions are not excepted from the Commission's jurisdiction by virtue of the exception for "local distribution facilities."

Finally, California attempts to rely on its own well known problems with power supply as a reason for this Court to reject FERC's jurisdictional rule. Calif. Br. at 1-2, 27. California offers no support for its assertion that its recent problems were caused by FERC's assertion of jurisdiction over unbundled retail transmission. With or without such

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[28] *See United States v. Public Utilities Comm'n of Cal.*, 345 U.S. 295, 316 (1953) ("[T]he facilities supplied 'local distribution' only after the current was subdivided for individual consumers."); *East Ohio Gas Co.*, 338 U.S. at 469-70 ("[W]hat Congress must have meant by 'facilities' for 'local distribution' was equipment for distributing gas among consumers within a particular local community, not the high-pressure pipe lines transporting the gas to the local mains.").

jurisdiction, FERC would still possess authority over all wholesale transactions in the state and would still lack authority over bundled retail sales. California's problems are severe, but they are not related to the Commission's assertion of jurisdiction over the specific category of transmission lines used in unbundled retail sales.[29] California's recent troubles do not change the legal analysis here.

II. FERC LAWFULLY DECLINED TO ASSERT JURISDICTION OVER TRANSMISSION THAT IS BUNDLED WITH A RETAIL SALE.

In Order No. 888, FERC limited its jurisdiction at the retail level to interstate transmission that occurs when states direct or permit utilities to unbundle their services. FERC therefore preserved State jurisdiction over bundled retail transmission that had been exercised before the FPA was enacted and that has continued to be exercised for the last 65 years under the FPA. Enron now seeks to displace this established regulatory scheme, arguing that FERC should have exercised exclusive jurisdiction over *all* transmission at the retail level even if bundled with a retail sale.

The reach of this assertion is breathtaking. Enron's position means that for the five or more decades since the interstate nature of transmission on the grid has been established, FERC has been failing in its duty to regulate the transmission component of bundled retail sales; all state commissions have been erroneously asserting jurisdiction over the transmission aspect of such sales; and all reviewing courts have erred in failing to recognize and enforce this distinction. Enron's position would also require all existing

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[29] For example, California's approach would not alter FERC's authority to regulate the Independent System Operator ("ISO"), because FERC has jurisdiction over wholesale transactions, including unbundled wholesale transmissions, for which the ISO is primarily responsible.

bundled retail rates to be unbundled and re-established, an enormous undertaking.

In viewing transmission for a bundled sale as part and parcel of the retail sale, FERC adopted a reasonable interpretation of the statutory language, which accords with the history of operation under the statute. FERC also limited the scope of its mandatory open access tariff to those markets in which it is needed: those in which transmission owners are competing against generators for the same retail customers. If there is any ambiguity in the statute, FERC's interpetation should be upheld as a reasonable construction entitled to judicial deference.

A. Enron Ignores Statutory Language That Preserves Pre-Existing State Jurisdiction Over Bundled Retail Sales.

Section 201(b) reserves to the States jurisdiction over all retail sales of electricity. Under that provision, the Act applies to interstate transmission or wholesale sales of electric energy but not "to any other sale of electric energy." 16 U.S.C. § 824(b). FERC reasonably viewed transmission bundled in a retail sale as an integral component of that sale of energy. It therefore properly refrained from taking jurisdiction in light of the express terms of the proviso.

Enron does not challenge the Commission's characterization of bundled transmission. In fact, Enron admits that the transmissions for which it seeks federal jurisdiction are "components of a bundled retail sale . . . legally as well as factually." Enron Br. at 18. Given a proviso that expressly excludes "any other sale of electric energy," this admission should be fatal.

Enron would apparently read this proviso out of the statute. Neither its opening nor its responsive brief mentions it. Enron reasons: "Transmission of energy across state borders does not cease to be interstate transmission merely because it

is bundled with a sale of energy as an invoicing matter." Enron Br. at 18.

This reasoning is flawed at its core. The question is not whether a transmission ceases to be interstate, but rather whether, as a component of a bundled sale, it is excluded under the terms of a proviso that carves out "any other sale of electric energy." Order No. 888 gives meaning to that language because it finds that a transmission service that might otherwise meet a jurisdictional requirement (interstate transmission) is *excluded* from FERC jurisdiction. This reading gives effect to all of the language in the statute. Otherwise, the "other sale" proviso would have no purpose. It would redundantly exclude the very same non-wholesale sales that are left out of § 201(b)'s jurisdictional grant.

Moreover, like New York, Enron is wrong to characterize the bundling of retail sales as only an "invoicing matter." When transmission is bundled in a retail sale, there is not only a single price, but also a single product—delivered energy. The consumer can buy only that product and only from one utility in a single transaction. The utility's delivery of the energy to the consumer is thus an inseparable aspect of the utility's "sale of electric energy" within the meaning of the proviso to § 201(b). As FERC stated, "we believe that when transmission is sold at retail as part and parcel of the delivered product called electric energy, the transaction is a sale of electric energy at retail." Pet. App. at 306a.

FERC's interpretation not only gives meaning to the proviso of § 201(b); it also fits well with the declaration in § 201(a), which reserved to the States their preexisting regulatory jurisdiction. In 1935, there were already a substantial number of bundled retail sales involving what was found to be interstate transmission within the State's regulatory authority. *Mill Creek Coal*, like *Pennsylvania Gas* in the natural gas area, exemplified this phenomenon.

Congress clearly intended to give regulation of such sales to the States.

The legislative record surrounding the 1935 Act confirms this point. It shows that Congress intended to preserve existing state authority over bundled retail sales of electric power, including those that involved interstate transmission over an integrated system. Both Committee reports state that the bill leaves to the States their authority over retail sales of electric energy, even where that energy is brought in from out of state.[30] In proposing the bill later enacted into the FPA, FPC Solicitor DeVane repeatedly stated during his testimony that the States would retain jurisdiction over bundled retail service even when interstate transmission was involved.[31] While legislative history may be of questionable value in applying a statute to a product or service that was not even known to the enacting Congress (such as unbundled retail transmission), it has force when legislators have specifically considered the situation and consistently expressed their intent.

In the years that followed, FERC never asserted any jurisdiction over the transmission aspects of bundled retail sales[32] and the States universally did

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[30] *See* S. Rep. No. 74-621, at 48 (1935) ("This subsection leaves to the States the authority to fix local rates even in cases where the energy is brought in from another State."); H.R. Rep. No. 74-1318, at 27 (1935) ("[T]he authority of States to fix local rates is not disturbed even in those cases where the energy is brought in from another State.").

[31] Mr. DeVane made his views explicit in a colloquy with Congressman Monoghan. *See Pub. Util. Holding Cos.: Hearings on H.R. 5423 Before the House Committee on Interstate and Foreign Commerce*, 74th Cong. 521-22 (1935).

[32] Enron concedes that "the Commission heretofore has not exercised its . . . authority to regulate transmission to a retail customer." Application of the Coalition for a Competitive Electric Market for Reconsideration and Clarification or, In the Alternative, Rehearing of

so.[33] This longstanding interpretation by the federal agency charged with administration of the Act is entitled to considerable deference. *E.g., United States v. Cleveland Indians Baseball Co.*, 121 S. Ct. 1433, 1444-45 (2001) (according "substantial" deference to agency's 61-year interpretation); *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 274-75 (1974).

Moreover, Congress has twice amended the jurisdictional sections of the FPA, but has left alone state regulation of bundled retail sales. *See* PURPA, Pub. L. No. 95-617, Title II, § 204(b), 92 Stat. 3140 (1978); Energy Policy Act, Pub. L. No. 102-486, Title VII, § 714, 106 Stat. 2911 (1992). In these circumstances, Congress has acquiesced in the existing federal-state allocation of jurisdiction over bundled retail sales. *See FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 143-61 (2000); *Bob Jones Univ. v. United States*, 461 U.S. 574, 599-601 (1983).

Indeed, in 1992, Congress enacted amendments to the FPA that confirmed the inability of the Commission to deal with transmission aspects of a bundled retail sale. In § 212(h) of the FPA, Congress precluded FERC from conditioning any of its orders upon or directing "the transmission of electric energy . . . directly to an ultimate consumer." 16 U.S.C. § 824k(h). In effect, FERC was barred from ordering that any utility provide "retail wheeling" — mandatory transmission access to any retail consumer.

Order No. 888, at 5 (May 24, 1996) (FERC Docket Nos. RM95-8-00 and RM94-7-001).

[33] *See, e.g.*, Pet. App. 28a, 30a; *People ex. rel. Horton v. Prendergast*, 162 N.E. 10, 12 (N.Y. 1928); *see also* Hon. Ashley C. Brown, *State Power Over Transmission Access and Pricing: The Giant Will Not Sleep Forever*, 124 Pub. Utils. Fort. 21 (1989) ("State jurisdiction over retail rate making provides for considerable influence over transmission policy. The bulk of transmission pricing is already done by the states in the course of retail ratemaking.") (*available in* Westlaw TP-ALL).

At the same time, Congress did nothing to disturb the existing state regulation of bundled transmission at the retail level and specifically sought to preserve it. "Nothing in this subsection shall affect any authority of any State or local government under State law concerning the transmission of electric energy directly to an ultimate consumer." 16 U.S.C. § 824k(h). This section necessarily assumes that States have some degree of authority over transmission to a consumer and would be meaningless if Enron's interpretation of FPA § 201(b) were correct. Where "Congress has not just kept its silence by refusing to overturn the administrative construction, but has ratified it with positive legislation, we cannot but deem that construction virtually conclusive." *CFTC v. Schor*, 478 U.S. 833, 846 (1986) (quotations and citation omitted).

At this point, a rule classifying transmission underlying bundled retail sales as subject to federal jurisdiction would create a huge regulatory burden and uncertainty in the industry. It would require FERC to go back and reset the price for the transmission component of every such retail sale, and then force every State that has not unbundled retail services to establish separate rates for the generation and distribution components of the rates for each utility subject to its jurisdiction. Absent a clear showing of such intent, the statute should not be interpreted to disturb the established federal and state practices governing the regulation of bundled retail sales and to inject such regulatory uncertainty into the industry.

B. The NGA Case Law Does Not Compel a Conclusion That FERC Has Jurisdiction Over Bundled Retail Transmission.

Lacking supporting FPA cases, Enron resorts to the case law delineating FERC's jurisdiction under the Natural Gas Act ("NGA"), such as this Court's decision in *FPC v. Louisiana Power & Light Co.*, 406 U.S. 621 (1972). The

NGA case law, however, though sometimes relevant to interpreting the FPA, is not on-point here, and does not compel the extension of FERC jurisdiction to bundled retail transmission.

As Enron points out, this Court has an "established practice of citing interchangeably decisions interpreting the *pertinent* sections of the two statutes." *Arkansas Louisiana Gas Co v. Hall*, 453 U.S. 571, 577 n.7 (1981) (emphasis added). But the Court has never stated that the *jurisdictional* provisions of the two statutes are interchangeable, and with good reason. Jurisdictional principles under the Natural Gas Act have developed differently in light of the characteristics of the gas industry and the somewhat different structure of that statute. A mechanical appropriation of the law from the NGA to the FPA in the jurisdictional context would be inappropriate.

Congress enacted the jurisdictional provisions of the FPA and NGA against the backdrop of two industries that already had different origins and organizational structures. Electrical generation facilities were typically sited in or near the service territory of the utility, but gas fields had to be exploited where they were found. Most gas had to be transported by pipeline at long distances and across State lines from gas fields located in a few producing areas.[34] Interstate pipelines were therefore widely used to bring gas from producing regions to consuming states. Moreover, the gas industry was characterized by separate ownership of the individual segments of the industry, whereas the electric industry has been historically characterized mostly by vertical ownership and

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[34] *See Pennsylvania v. West Virginia*, 262 U.S. 553, 586-87 (1923); *see also Hearings on H.R. 11662 Before House Committee on Interstate and Foreign Commerce*, 74th Cong. 117 (statement of John E. Benton, General Solicitor of Railroad and Utilities Commissioners) ("Thirty-seven States which now use natural gas to a greater or less extent obtain most of that gas, with the exception of six or eight States, outside of their own borders.").

integrated generation of all segments of the business.[35] Thus, interstate transportation was typically handled by companies different from those that handled production and distribution.[36] In effect, in the gas industry, the transportation function had already been unbundled from the retail sale of the gas.

In these circumstances, Congress sought to place all interstate transportation of natural gas under federal control.[37] In § 7 of the NGA, Congress imposed a certification requirement that was intended to work together with FERC's jurisdiction under NGA § 1(b).[38] NGA § 7(c) requires gas companies to obtain from FERC a certificate of public convenience and necessity before constructing or operating any facility for the transportation or making of any

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[35] *See Cities of Aitkin v. FERC*, 704 F.2d 1254, 1257 n.4 (D.C. Cir. 1982) ("the natural gas industry is relatively unintegrated in comparison to the electric industry"); *see also* EDWARD KAHN, ELECTRIC UTILITY PLANNING AND REGULATION 16-21, 306-07 (1988) ("The natural gas industry is substantially less integrated than the electric utilities industry . . . The pipeline companies were the major developers of the gas industry, but they had relatively little corporate connection either to the local distribution companies or the gas suppliers."); JAMES C. BONBRIGHT, ET AL., PRINCIPLES OF PUBLIC UTILITY RATES 622 (1988) ("vertical integration is much less common than in the electric industry").

[36] Kahn, *supra* note 35, at 306-07.

[37] *See Hearings on H.R. 11662 Before House Committee on Interstate and Foreign Commerce*, 74th Cong. 56 (1936) (statement of Dozier A. DeVane, Solicitor, Federal Power Commission) ("The whole purpose of this bill is to bring under Federal regulation the pipe lines and to leave to the State commissions control over distributing companies and over their rates, whether that gas moves in interstate commerce or not.").

[38] *See Hearings on H.R. 11662 Before House Committee on Interstate and Foreign Commerce*, 74th Cong. 435 (statement of Chairman Lea) (1936) ("The gas industry is in a separate position from other utilities. There is greater reason for this provision [NGA § 7(c)] in the case of gas than electricity.").

jurisdictional sale.[39] There is no parallel certification requirement in the FPA.

The Commission and the courts concluded relatively early in the statute's history that the agency would have § 7(c) certificate authority over transportation for "direct sales"—which were typically sales of gas in large volumes and high pressure to industrial customers. *See Panhandle Eastern Pipe Line Co.*, 232 F.2d 467, 471-72 (3d Cir.), *cert. denied*, 352 U.S. 891 (1956). This was consistent with this Court's view that "transportation of natural gas in interstate commerce" encompassed movements in high-pressure pipelines. *East Ohio Gas Co.*, 338 U.S. at 472-73.

It was in this context that this Court decided *FPC v. Louisiana Power & Light Co.*, 406 U.S. 621, 640-41 (1972). It upheld the Commission's power to curtail direct sales to industrial customers, sales that were already certificated pursuant to § 7 (*see id.* at 624). In order to give effect to the Commission's powers over transportation under § 7, the Court adopted a broad interpretation of the jurisdictional provision of the NGA, permitting the exercise of authority over transportation even when the sales themselves were exempt from FPC jurisdiction. The Court also relied directly on the legislative history of the NGA: "That rate setting was the only subject matter covered by [the exception for] 'sales' . . . is clear from the legislative history of the proviso." 406 U.S. at 639. Because *LP&L* focused on direct industrial sales and rested on the different structure and history of the Natural Gas Act, it is not an accurate guide to the treatment of other forms of retail transmission under the Federal Power Act. *Cf. Algonquin Gas Transmission Co. v. FERC*, 809 F.2d 136,

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[39] This Court has also noted, "[T]he initial interest of Congress in regulation of transportation facilities was reemphasized in 1942 by passage of an amendment to § 7(c) of the Act broadening the Commission's powers over the construction or extension of pipe lines." *East Ohio Gas Co.*, 338 U.S. at 468.

142-43 & n.10 (1st Cir. 1987) ("[T]hat two different industries regulated under two different statutes must be treated exactly alike, is utterly unpersuasive.).[40]

If the NGA cases have any relevance here, at most they suggest that § 201(b) is susceptible to another interpretation than FERC adopted. These cases do not *compel* the reading urged by Enron. As the Court of Appeals pointed out, "[a] regulator could reasonably construe transmissions bundled with generation and delivery services and sold to a consumer for a single charge as either transmission services in interstate commerce or as an integral component of a retail sale." Pet. App. 35a. FERC's construction was reasonable in light of the language of the statute and its own distinctive history, which recognizes the role of the states in regulating all aspects of bundled retail sales. FERC's choice among reasonable interpretations is entitled to appropriate deference. *See Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984) ("[A] court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency.") (footnote omitted).

C. Regulation of Bundled Sales Is Not Necessary to Fulfill the Stated Objectives of Order No. 888.

Enron and its allies argue that, by failing to take jurisdiction over the interstate transmission component of bundled retail service, FERC left in place an unduly

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[40] For example, in *LP&L*, this Court explained that curtailment of industrial customers (many of whom had alternative sources of supply) was necessary to assure fairness to residential customers whose sales were already being curtailed and who had no such options. 406 U.S. at 632. Here, Enron would invoke this case to achieve the opposite result—an expansion of federal jurisdiction to encompass bundled sales to residential customers who have no choice, so that Enron may make use of that transmission capacity in its own competitive transactions.

discriminatory situation that is inconsistent with its own stated objectives in issuing Order No. 888. They assert that public utilities have acted discriminatorily in providing transmission services to their own bundled retail customers in comparison with the services that they provide under the Order No. 888 open access tariffs. This argument fails for several reasons.

First, the argument puts the cart before the horse. The question before the Court is whether Congress granted jurisdiction to FERC to regulate the interstate transmission component of bundled retail service in the first instance. If FERC does not have such jurisdiction under the Federal Power Act, it is irrelevant whether, as a policy matter, FERC's failure to impose a remedy is adversely affecting Enron's interests as an unbundled transmission user in other markets. FERC's jurisdiction under FPA § 206 to eliminate undue discrimination applies to the facilities and services over which it has jurisdiction. It does not give the FERC unbridled authority to regulate services that are subject to exclusive State jurisdiction.

Second, FERC's findings of undue discrimination in Order No. 888 involved the potential for transmission-owning utilities to favor their own power sales in markets where the utilities must compete for those sales. FERC did not make factual findings in Order No. 888 that transmission-owning utilities engaged in undue discrimination against competitors with respect to the utilities' bundled retail sales, because there is no competition for such sales. A utility providing service to bundled retail customers generally has an exclusive state franchise to serve those customers, and a comparable finding of undue discrimination with respect to that endeavor is not even an abstract possibility.

Third, Enron focuses on a different issue—whether utilities in states adhering to the traditional model of bundled service have discriminated unduly in favor of transmissions to their

native load and against transmissions to customers receiving unbundled service in competitive power markets in other states. However, FERC did not make any specific findings of undue discrimination on this issue, and Enron did not appeal FERC's failure to make such findings.

In order for FERC to find that such discrimination exists under the Federal Power Act, it would first have to explore whether bundled retail customers are similarly situated to unbundled transmission customers, and whether any service differences are justified by the differences in customer characteristics.[41] FERC has previously recognized, and the reviewing court agreed, that bundled retail customers are *not* similarly situated with wholesale and unbundled retail customers. *See Northeast Utils. Serv. Co.*, 59 F.E.R.C. (CCH) ¶ 61,042, at 61,160 (1992), *aff'd*, 993 F.2d 937 (1st Cir. 1993); *cf. Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 299 (1997).

Bundled retail customers differ from those receiving unbundled service by the very fact that the former have no choice in service-providers. *See Northern States Power Co. v. FERC*, 176 F.3d 1090, 1095 (8th Cir. 1999) (most wholesale customers may use alternative supplies purchased from other utilities, whereas "[t]he native/retail consumer . . . is unable to turn to alternative sources of supply."), *cert. denied*, 528 U.S. 1182 (2000). As the Court recognized in *Tracy*, states might have various reasons for choosing to protect the residential customers who have no effective means

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[41] Undue discrimination under the Federal Power Act has long been defined as the disparate treatment of similarly situated FERC-jurisdictional customers. *E.g., Cities of Newark v. FERC*, 763 F.2d 533, 546 (3d Cir. 1985); *Metro. Edison Co. v. FERC*, 595 F.2d 851, 857 (D.C. Cir. 1979); *Pub. Serv. Co. of Ind., Inc. v. FERC*, 575 F.2d 1204, 1212 (7th Cir. 1978); *St. Michaels Utils. Comm'n v. FPC*, 377 F.2d 912, 916 (4th Cir. 1967). These precedents recognize that differences in customer characteristics may justify the imposition of different regulatory rules.

of choosing an alternative supplier. *See Gen. Motors Corp. v. Tracy*, 519 U.S. at 304-06. Indeed, traditional bundled service involves a "regulatory bargain," wherein the utility receives an exclusive franchise but assumes certain duties to its customers. "In return for this obligation to serve, the native load customers regularly bear the cost of transmission facilities; native load customers pay for them, use them, plan on them, and rely on them." *Northeast Utils. Serv. Co. v. FERC*, 993 F.2d 937, 954 (1st Cir. 1993); *see also* Order No. 888-A, 62 Fed. Reg. at 12,301. Thus, FERC has held that it is not discrimination when a utility providing service to its native load customers reserves transmission capacity for that purpose, and that view has been affirmed. *Id.*

The FERC also took concrete steps within the scope of its jurisdiction to address the concern of Enron and its allies that utilities will abuse their right to reserve transmission for their native load. FERC has consistently made clear that it will review a utility's available transmission capacity calculations, including the "set-aside" for bundled retail service (*i.e.*, for "native load"), to ensure that utilities do not arbitrarily withhold transmission capacity from the open access market. Thus, in several post-Order No. 888 cases, the FERC has reviewed utilities' transmission reservations for bundled retail load, and in some cases has ordered utilities to release capacity for use under open access tariffs.[42] FERC has also taken other steps to ensure that its supervision over reservations of capacity for the native load provides an

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[42] *E.g., Wisconsin Power & Light Co.*, 84 F.E.R.C. (CCH) ¶ 61,120, at 61,658-59 (1998); *El Paso Elec. Co.*, 87 F.E.R.C. (CCH) ¶ 61,202 (1999); *Arizona Pub. Serv. Co. v. Idaho Power Co.*, 87 F.E.R.C. (CCH) ¶ 61,303, at 62,223 (1999); *see also Capacity Benefit Margin in Computing Available Transmission Capacity*, Order Clarifying Methodology for Computing Available Transmission Capability, 88 F.E.R.C. (CCH) ¶ 61,099 (1999).

effective remedy.[43] And with respect to any capacity that is available for open access transmission, customers under the Order No. 888 open access tariff must receive the same degree of firmness as the utility's native load.[44] FERC has not left a jurisdictional void that utilities are able to use to unfairly restrict transactions in competitive markets.[45]

Lastly, Enron's brief seems to suggest that FERC should have exercised jurisdiction over bundled retail sales in order to facilitate retail competition in those States that have not volunteered to endorse this change. Enron Br. 34-38. Thus, it appears Enron may be using this jurisdictional dispute to help open up those retail markets for competition in order to obtain a broader customer base for its competitive services. As noted earlier, Congress has spoken to this question. Section 212(h) leaves to the States the question whether to require utilities to provide unbundled transmission services for retail customers. In the proper exercise of jurisdiction over matters of local concern, States may legitimately conclude that retail services should not be supplied competitively, and thus maintain their jurisdiction over all aspects of such services. It is this very choice that FERC correctly left to the States.

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[43] For example, FERC ruled that public utilities must identify their sources of generated or purchased power in order to permit other parties to ascertain whether the utilities' transmission set asides for bundled retail customers are reasonable. Order No. 888, 61 Fed. Reg. at 21,605.

[44] *Id.*

[45] Enron's amici raise various policy arguments about abusive or sham reservations for native load transmissions. These arguments belong before FERC or state commissions, not before the Court. Their concerns can and should be addressed through government policy. For example, a key objective of the Administration's recently announced energy plan is to expand transmission capacity to eliminate constraints on the grid. *See* Report of the National Energy Policy Development Group, "Reliable, Affordable, and Environmentally Sound Energy for America's Future," available at *www.whitehouse.gov/energy/ Overview*.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

EDWARD H. COMER
BARBARA A. HINDIN
EDISON ELECTRIC INSTITUTE
701 Pennsylvania Ave., N.W.
Washington, D.C. 20004
(202) 508-5000

CHARLES G. COLE
Counsel of Record
DAVID B. RASKIN
ALICE E. LOUGHRAN
STEPTOE & JOHNSON LLP
1330 Connecticut Ave., N.W.
Washington, D.C. 20036
(202) 429-6270

Counsel for Respondent Edison Electric Institute

APPENDIX

Section 201 of the Federal Power Act, 16 U.S.C. § 824 provides in relevant part:

Declaration of policy; application of subchapter

(a) Federal regulation of transmission and sale of electric energy

It is declared that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation of matters relating to generation to the extent provided in this subchapter and subchapter III of this chapter and of that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States.

(b) Use or sale of electric energy in interstate commerce

(1) The provisions of this subchapter shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce, but except as provided in paragraph (2) shall not apply to any other sale of electric energy or deprive a State or State commission of its lawful authority now exercised over the exportation of hydroelectric energy which is transmitted across a State line. The Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction, except as specifically provided in this subchapter and subchapter III of this chapter, over facilities used for the generation of electric energy or over facilities used in local distribution or only for the

transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter.

(2) The provisions of sections 824i, 824j, and 824k of this title shall apply to the entities described in such provisions, and such entities shall be subject to the jurisdiction of the Commission for purposes of carrying out such provisions and for purposes of applying the enforcement authorities of this chapter with respect to such provisions. Compliance with any order of the Commission under the provisions of section 824i or 824j of this title, shall not make an electric utility or other entity subject to the jurisdiction of the Commission for any purposes other than the purposes specified in the preceding sentence.

(c) Electric energy in interstate commerce

For the purpose of this subchapter, electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof; but only insofar as such transmission takes place within the United States.

(d) "Sale of electric energy at wholesale" defined

The term "sale of electric energy at wholesale" when used in this subchapter, means a sale of electric energy to any person for resale.

Section 212(h) of the Federal Power Act, 16 U.S.C. § 824k(h), provides:

(h) Prohibition on mandatory retail wheeling and sham wholesale transactions

No order issued under this chapter shall be conditioned upon or require the transmission of electric energy:

(1) directly to an ultimate consumer, or

(2) to, or for the benefit of, an entity if such electric energy would be sold by such entity directly to an ultimate consumer, unless:

(A) such entity is a Federal power marketing agency; the Tennessee Valley Authority; a State or any political subdivision of a State (or an agency, authority, or instrumentality of a State or a political subdivision); a corporation or association that has ever received a loan for the purposes of providing electric service from the Administrator of the Rural Electrification Administration under the Rural Electrification Act of 1936 [7 U.S.C. § 901 *et seq.*]; a person having an obligation arising under State or local law (exclusive of an obligation arising solely from a contract entered into by such person) to provide electric service to the public; or any corporation or association which is wholly owned, directly or indirectly, by any one or more of the foregoing; and

(B) such entity was providing electric service to such ultimate consumer on October 24, 1992, or would utilize transmission or distribution facilities that it owns or controls to deliver all such electric energy to such electric consumer.

Nothing in this subsection shall affect any authority of any State or local government under State law concerning the transmission of electric energy directly to an ultimate consumer.

Section 313(b) of the Federal Power Act, 16 U.S.C. § 825*l*(b), reads in pertinent part:

(b) Judicial review

Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the United States Court of Appeals . . . Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the

Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of title 28.

Sections 1(a) and (b) of the Natural Gas Act, 15 U.S.C. §§ 717(a), (b), provide:

Regulation of natural gas companies

(a) Necessity of regulation in public interest

As disclosed in reports of the Federal Trade Commission made pursuant to S.Res. 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest.

(b) Transactions to which provisions of chapter applicable

The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

Section 7(c) of the Natural Gas Act, 15 U.S.C. § 717f(c), reads:

(c) Certificate of public convenience and necessity

(1)(A) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: Provided, however, That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on February 7, 1942, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after February 7, 1942. Pending the determination of any such application, the continuance of such operation shall be lawful.

(B) In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: Provided, however, That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to

serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

(2) The Commission may issue a certificate of public convenience and necessity to a natural-gas company for the transportation in interstate commerce of natural gas used by any person for one or more high-priority uses, as defined, by rule, by the Commission, in the case of—

(A) natural gas sold by the producer to such person; and

(B) natural gas produced by such person.

18 C.F.R. § 35.28, reads in relevant part:

Non-discriminatory open access transmission tariff.

(a) Applicability. This section applies to any public utility that owns, controls or operates facilities used for the transmission of electric energy in interstate commerce and to any non-public utility that seeks voluntary compliance with jurisdictional transmission tariff reciprocity conditions.

* * * *

(c) Non-discriminatory open access transmission tariffs.

(1) Every public utility that owns, controls or operates facilities used for the transmission of electric energy in interstate commerce must have on file with the Commission a tariff of general applicability for transmission services, including ancillary services, over such facilities. Such tariff must be the open access pro forma tariff contained in Order No. 888, FERC Stats. & Regs. ¶ 31,036 (Final Rule on Open Access and Stranded Costs) or

such other open access tariff as may be approved by the Commission consistent with Order No. 888, FERC Stats. & Regs. ¶ 31,036.

* * * *

(2) Every public utility that owns, controls or operates facilities used for the transmission of electric energy in interstate commerce, and that uses those facilities to engage in wholesale sales and/or purchases of electric energy, or unbundled retail sales of electric energy, must take transmission service for such sales and/or purchases under the open access tariff filed pursuant to this section.

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In the

Supreme Court of the United States

STATE OF NEW YORK, ET AL., *Petitioners*,

v.

FEDERAL ENERGY REGULATORY COMM'N, ET AL.

ENRON POWER MARKETING, INC., *Petitioner*,

v.

FEDERAL ENERGY REGULATORY COMM'N, ET AL.

On Writ of Certiorari to the United States
Court of Appeals for the District of Columbia Circuit

BRIEF *AMICUS CURIAE* OF ELECTRICAL ENGINEERS, ENERGY ECONOMISTS AND PHYSICISTS IN SUPPORT OF RESPONDENTS IN NO. 00-568

CHARLES J. COOPER
Counsel of Record
BRIAN STUART KOUKOUTCHOS
COOPER & KIRK, PLLC
Suite 200
1500 K Street, N.W.
Washington, D.C. 20005
(202) 220-9600

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INTEREST OF AMICI CURIAE

Amici curiae are electrical engineers, economists, and physicists specializing in the study of electricity and the operation of electric power systems. They have an abiding professional interest in the proper regulation of the ever more important electric energy industry.[1] American dependence upon electric energy has nearly doubled in the last three decades as the nation steadily moves beyond fossil fuels. Electricity's share of U.S. primary energy use is expected to reach 46% by the year 2010. J. Duncan Glover & Mulukutla Sarma, POWER SYSTEM ANALYSIS AND DESIGN 8 (1994).

The division of state and federal regulatory jurisdiction set forth in the Federal Power Act of 1935 was deliberately drawn by Congress in accord with the scientific and engineering realities of electric power generation, transmission, and distribution. As scholars and consultants specializing in those fields, *Amici* respectfully submit this brief as an aid to this Court's understanding of those principles of physics and engineering, and their relevance to the application of the "engineering and scientific test" that Congress has prescribed for deciding questions of federal jurisdiction. Counsel of record for all parties have consented to the filing of this brief.[2]

SUMMARY OF ARGUMENT

Congress wrote the Federal Power Act ("FPA") in the language of electrical engineers and mandated that federal jurisdiction follow the flow of electric energy — an engineering

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[1]The qualifications of and positions held by *Amici* are set forth in Appendix B, bound with this brief. *Amici* appear here in their individual capacities as scholars, scientists and engineers, rather than as representatives of the institutions with which they may be affiliated. This brief has been financed by the *Amici* with support from Dynergy, Inc., and Coral Energy. No counsel for any party authored this brief in whole or in part, nor did any party make a monetary contribution to the brief.

[2] Letters of consent have been filed with the Clerk.

and scientific, rather than a legalistic or governmental, test. Yet the state public service commissions ("PUCs") challenging FERC's jurisdiction under Order 888 misunderstand the physics of electric energy and how it is transmitted, and therefore misapply the FPA's test for federal jurisdiction.

The PUCs base their argument for restrictions on FERC jurisdiction on an inaccurate and misleading metaphor. They imagine electrons entering one end of a transmission wire at a generating plant, flowing through the wire like drops of water through a pipe, and then emerging at the other end of the wire in a lightbulb in a home. They imagine electrons as discrete items whose transmission can be controlled, directed and traced. They extend this metaphor to argue that FERC does not have jurisdiction to regulate the interstate transmission of such a stream of electrons unless it can show that every electron used by a retail customer in each state is generated in a different state.

But this is not how electricity works. *Energy* is transmitted, not electrons. Energy transmission is accomplished through the propagation of an electromagnetic wave. The electrons merely oscillate in place, but the *energy* — the *electromagnetic wave* — moves at the speed of light. The energized electrons making the lightbulb in a house glow are not the same electrons that were induced to oscillate in the generator back at the power plant.

Electric energy on an alternating current network *cannot* be addressed like a phone number or an e-mail and dispatched to a particular recipient over a prescribed and fixed pathway. Energy flowing onto a power network or grid *energizes the entire grid,* and consumers then draw undifferentiated energy from that grid. A networked electric grid flexes, and electric current flows, in conformity with physical laws, and those laws do not notice, let alone conform to, political boundaries. If the transmission lines of the system cross state boundaries, then electric currents on the system necessarily do likewise. With the exception of transmissions on the electric grids isolated in the states of Hawaii, Texas, and Alaska, *all* transmissions are interstate because *all* transmission lines are part of one of the two vast

American electric grids that span multiple state boundaries. The State PUCs' arguments to the contrary defy established principles of physics and electrical engineering.

The PUCs misunderstand power system structure and operation and therefore misapprehend the division of state and federal jurisdiction under the FPA. They try to rewrite the vocabulary for electric regulatory discourse by introducing new concepts of "retail transmission" and "wholesale transmission." These terms are fabrications that do not appear in the FPA. "Wholesale" and "retail" are transactional terms, which is why the FPA uses them only to distinguish types of *sales*. These terms have no relevance to the *transmission* of electricity.

The PUCs would like to pretend that the world has not changed since 1935. They contend that the massive increase in interstate, interconnected electric networks is not relevant to the jurisdictional issue because this change did not alter the FPA's language. The PUCs accuse FERC of trying to rewrite the FPA's jurisdictional assignments to invade the regulatory sphere reserved to the states.

There has been no change in the FPA's text or interpretation. The jurisdictional lines drawn in the FPA are still the same: the states get generation, distribution, and intrastate transmission, while FERC gets interstate transmission. What has happened is that the electrical system being regulated has changed. Interconnected networks and interstate transmissions were few and far between in 1935; today every high-voltage transmission line in the continental U.S. (outside Texas) is wired into one of the two vast interstate grids. Thus, the electrical transmission system has become inherently interstate — and has thereby grown away from the state regulatory territory defined by the FPA and grown into federal territory.

ARGUMENT

In the Federal Power Act, 16 U.S.C. § 824(b)(1), Congress allocated regulatory jurisdiction over electric energy along lines

drawn, in effect, by electrical engineers.[3] That is, the electric power industry was divided into three categories — generation, local distribution, and transmission — and the states were given jurisdiction over "facilities used for the generation of electric energy or over facilities used in local distribution," while the Federal Power Commission (now known as FERC) was given jurisdiction over "the transmission of electric energy in interstate commerce." *Id.*

Accordingly, this Court has long held that the question of federal vs. state jurisdiction under the FPA turns in large part on the physical realities of science and electrical engineering. Congress wrote the FPA "in the technical language of the electric art" and decreed that "[f]ederal jurisdiction was to follow the flow of electric energy, an engineering and scientific, rather than a legalistic or governmental, test." *Connecticut Light & Power Co. v. FPC*, 324 U.S. 515, 529 (1945). Thus here, as in so many previous cases, it is an "'engineering and scientific test' that controls this case." *FPC v. Florida Power & Light Co.*, 404 U.S. 453, 467 (1972).

Amici curiae, as engineers and other experts schooled and experienced in the "electric art," submit this brief as an aid to the Court's understanding of this "engineering and scientific test." In particular, *Amici* are concerned because the parties challenging FERC's jurisdiction under Order 888 misapprehend and misrepresent the realities of the electric power system. We will first explain some of the fundamentals of physics and engineering relating to (1) the transmission of electricity and (2) the structure, operation and historical development of the electric power system. We will then apply those fundamentals to the arguments of those opposing FERC's jurisdiction.

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[3] 18 U.S.C. § 824(a)-(e) codifies the FPA § 201(a)-(e). In conformity with the parties' practice, the FPA will usually be cited by reference to its original section numbers rather than as codified in the U.S. Code.

I. THE PHYSICAL REALITIES OF THE TRANSMISSION OF ELECTRICITY.

The State Public Service Commissions ("PUCs" or "States"), which argue for restrictions on FERC jurisdiction over the transmission of electricity, base their argument on an inaccurate and highly misleading, albeit popular, metaphor of electrons flowing down transmission wires the way water flows through a pipe or blood cells flow through a vein. Metaphors are of course familiar elements of human discourse, but care must be taken in their use. "Half the wrong conclusions at which mankind arrive," Palmerston once observed, "are reached by the abuse of metaphors, and by mistaking general resemblance or imaginary similarity for real identity." P. Guedella, PALMERSTON 226 (1927). The problem is that a metaphor can convey a multitude of properties or characteristics, and not all of them may be appropriate as resemblances to the object or concept that is being described by the metaphor.

> [I]t has to be remembered that every image is true and helpful only at its relevant point. God is, in a manner, light: but He is not a succession of wave-lengths in the prime matter . . . . [N]early all heresies arise from the pressing of a metaphor beyond the point where the image ceases to be relevant.

D. Sayers, THE POETRY OF SEARCH AND THE POETRY OF STATEMENT 284 (1963). Therefore, "[m]etaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it." *Berkey v. Third Ave. Ry.*, 224 N.Y. 84, 94, 155 N.E. 58, 61 (1926)(Cardozo, J.).[4]

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[4] *See generally* Michael Boudin, *Antitrust Doctrine and the Sway of Metaphor*, 75 GEO. L.J. 395, 414-16 (1986); Brian Koukoutchos, *Constitutional Kinetics: The Independent Counsel Case and the Separation of Powers*, 23 WAKE FOREST L. REV. 635, 643-46 (1988).

The State PUCs indulge in the metaphor that electrons, like water molecules or blood cells, are discrete physical entities that flow though a transmission pipeline. Electrons are deemed to be individual products "generated" in one place by an electric dynamo, then "carried" through a transmission wire where they "mingle" with other electrons, and ultimately "consumed" by a customer to power a lightbulb or appliance. *See* State PUCs Br. in No. 00-568, at 42, 43, 43-44, 45 & nn.27-28. The States extend this metaphor to argue that FERC does not have jurisdiction to regulate the interstate transmission of such a stream of electrons unless FERC can "show that essentially every electron used by a retail customer in each state . . . is generated in a different state." *Id.* at 45 n.27. *See id.* at 43-44.

This is not how electricity works. Water pipe metaphors for the transmission of electricity are popular, *see, e.g.*, Larry Gonick & Art Huffman, THE CARTOON GUIDE TO PHYSICS 131 (1990), but misleading. The "thing" that is transmitted by the wire conduits suspended from those high-tension towers one sees is *energy*, not electrons. The State PUCs imagine electrons entering one end of a transmission wire at a hydroelectric plant, flowing through the wire like water through a pipe, and then emerging at the other end of the wire in a lightbulb in a home. But electricity is not an accumulation of electrons. It is the class of physical phenomena arising from the existence and interactions of electric charge. Electric charge is one of the fundamental properties of matter. Generators do not "generate" electrons — they do not create electrons from nothing. Nor do toasters and air conditioners "consume" electrons. Electrons are not generated or consumed — but *electric energy* is. Electrons do not "flow" — but *electric current* does.

Energy, or more precisely current, is indeed measured in terms of the net charge (that is, the electrons) flowing across an

area per unit of time.[5] However, it is not these electrons that travel at the speed of light and so transmit energy from generator to consumer. The electrons that actually move through the conducting wire, hopping from one atom to the next, pressed on by the electromotive force created at the generating plant, move much too slowly to transmit much energy. These electrons collide with atoms along the way, giving up some energy as heat (which is why an electrical appliance and the wire leading from it to the plug in the wall become warm).

This broken-field running of electrons through the conducting wire is known as drift velocity and it is quite slow — less than one inch per second, as compared to 186,282 *miles* per second, which is the speed of light and the speed at which electric *current* flows through a transmission line.[6] And in an *alternating current* ("AC") system, the dominant form of energy transmission in the United States, the flow of current reverses course sixty times a second. Therefore, the electrons *oscillate* back and forth, moving in unison one way, then back the other way, without net movement over time. Hence the movement of electrons from one atom to the next through the wire transmits little energy.

The real energy transmission is accomplished through the propagation of an electromagnetic wave. Each electron is induced, under the effect of the electromagnetic wave generated at the power plant, to repel the electron in the next atom. Assume that energy is being transmitted left to right in a wire.

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[5] The unit of electric charge is the coulomb. The unit for electric current is the ampere, equal to one coulomb per second. The unit for all types of energy is known as the joule, and the quantity of one joule per coulomb is a volt. Finally, the unit for power, the rate of transfer of energy, is the watt, which can also be represented as the product of voltage and current.

[6] The value of 186,282 miles per second is the speed of light in a vacuum. Energy travels slightly slower in any other material such as the copper conduit of an electric transmission line.

Each electron repels its right-hand neighbor, because they are both negatively charged and similar charges repel each other.[7] This ripple effect can be envisioned as each electron elbowing its neighbor toward the next right-hand neighboring electron, which in turn elbows the next electron, and so on down the power line. The electrons move very little, merely oscillating in place, but the *energy* — the *electromagnetic wave* — moves at the speed of light. The energized electrons making the lightbulb in a house glow are not the same electrons that were induced to oscillate in the generator at the generating plant.

Consider the familiar desktop toy of five or six shiny ball bearings suspended by wires from a pair of parallel horizontal bars. You lift the ball bearing on one end and allow it to fall and strike the neighboring ball bearing, and the first bearing and all the ones in the middle remain still while the bearing at the far end of the line absorbs the energy and swings out and up. The middle ball bearings, like the electrons in a transmission wire, are instrumental in *transmitting* the energy, but they do not themselves *travel* with that energy.

The water flowing in a pipeline differs from the electric current flowing in a transmission line in other respects. Water in a pipeline flows in one direction — away from the pump station to the homes of the users. And that flow is controlled and directed by the water company's staff who open and shut valves as needed. Not so for electricity. The path taken by electric energy is the path of least resistance (as determined in accord with an equation known as Ohm's Law)[8] — or, more accurately,

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[7] The oscillation of the electrons, initially induced by the electromagnetic wave, is also instrumental in the propagation of the wave throughout the transmission network.

[8] Ohm's Law is: $I = V/R$ (current equals voltage divided by resistance). Thus the higher the voltage, the more current flows through a conduit of a given resistance. Strictly speaking, Ohm's Law applies to direct current (DC) systems. For AC systems such as a modern American power grid, the equation involves complex mathematics (*e.g.*, V and I are represented as

the *paths* of least resistance. When more than one path is available, the energy spreads out and flows on *each path* in inverse proportion to the electrical resistance (or impedance) of that path.

The impedance of a conducting wire varies under the influence of a number of factors, including the temperature and the diameter of the wire, but the salient point is that electrical energy on an AC network *cannot* be directed. If there is more than one path available between two points, power system operators simply do not have the ability to direct the energy from a particular generator to flow on a particular set of transmission lines to a particular user.[9] Electricity cannot be addressed like a phone number or an e-mail and dispatched to a particular recipient over a prescribed and fixed pathway. Energy flowing onto a power grid *energizes the entire grid,* and consumers then draw undifferentiated energy from that grid.

For the power system to work, all the electricity on a given network must be on the same nominal frequency (60 cycles per second in North America) and all of the power generators must be synchronized and operated in parallel while they are simultaneously energizing the common grid. William Stevenson, ELEMENTS OF POWER SYSTEM ANALYSIS 3 (4th ed. 1982). The entire system operates in "electromagnetic unity." *Florida Power & Light Co.*, 37 F.P.C. 544, 549 (1967), *aff'd FPC v. Florida Power & Light Co.*, 404 U.S. 453 (1972).

The application of the concept of electromagnetic unity to power grids is not a novel approach concocted by FERC to

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vector values rather than scalar values and resistance is replaced by the concept of impedance). But the fundamental point remains the same.

[9] New technologies, including those known as FACTS devices, can assist operators in directing power flows to some degree, and a very small number are currently installed, for example, on the New York-New Jersey border. But their enormous cost prohibits their widespread installation for the foreseeable future.

justify the reach of Order No. 888. It is a fundamental premise of electrical engineering and it has been FERC's approach to jurisdiction over interstate transmission for at least 35 years. This Court summarized "the electromagnetic unity of response of interconnected electrical systems" in *Florida Power & Light*:

> None of the connected electric systems including that of [any particular utility] has any control over the actual transfers of power at each point of interconnection because of the free flow characteristics of electric networks . . . . An electric utility system is essentially an electro-mechanical system to which all operating generators on the interconnected network are interlocked electromagnetically. This means that electric generators, under ordinary operating conditions run either at exactly the same speed or at speeds which will result in a frequency of 60 cycles. No operating generator can change its speed by itself as long as it operates connected to the network . . . .
>
> If a housewife in Atlanta on the Georgia system turns on a light, every generator on Florida's system almost instantly is caused to produce some quantity of additional electric energy which serves to maintain the balance in the interconnected system between generation and load. If sensitive enough instruments were available and were to be placed throughout Florida's system the increase in generation by every generator . . . could be precisely measured.

404 U.S. at 460 (quoting Opinion of the Hearing Examiner, 37 F.P.C. at 567-68).

This understanding of the unity of electromagnetic response is anything but controversial. In *Florida Power & Light* itself, even the complaining utility company conceded that the approach was "technologically sound." 404 U.S. at 461-62. It

could hardly have argued otherwise, for electromagnetic unity is dictated by a set of four fundamental physical principles known as Maxwell's Equations. The import of these rules is that the sum of electrical currents flowing into any point in a circuit must equal the sum of currents flowing out, and the sum of voltages around any closed loop in a circuit must equal zero.[10]

These rules explain (1) why physical events — such as the addition of electrical energy or an increase in electrical load — cannot be isolated on an interconnected grid, and (2) why energy flowing on an interstate grid cannot be cabined within an arbitrary geographical boundary. If a generator on the grid increases its output, the current flowing from the generator on all paths on the grid increases. These increases affect the energy flowing *into* each point on the network, which in turn leads to compensating and corresponding changes in the energy flows *out* of each point. The increased generator output also affects the electromagnetic fields and the voltages on the grid, which must adjust themselves to sum to zero around all closed loops within the system. The system flexes and the current flows in conformity with physical laws, and those laws do not notice, let alone conform to, political boundaries. If the transmission lines of the system cross state boundaries, then electric currents on the system necessarily do likewise.

FERC's characterization in *Florida Power & Light* of an interconnected power grid as unified in electromagnetic response

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[10] Maxwell's Equations explain how oscillating electric fields (fields that vary over time) induce magnetic fields, and oscillating magnetic fields induce electric fields. The role of electric generators is to create these oscillating fields. Under certain conditions two of these equations can be used to derive a more familiar pair of rules known as Kirchhoff's Laws, which are rules for analyzing electrical circuits. Kirchhoff's Current Law states that the sum of electrical currents flowing into any node (point) in a circuit must equal the sum of currents flowing out. Kirchhoff's Voltage Law, based on one of Maxwell's Equations known as Faraday's Law, provides that the sum of voltages around any closed loop in a circuit must equal zero.

was based on a large administrative record of expert testimony. 37 F.P.C. at 549-50. That was the same type of electrical expertise to which this Court deferred in accepting FERC's conclusion that electrical energy from different sources is inevitably commingled in an electrical "bus" (an interconnection between two or more facilities). *Florida Power & Light*, 404 U.S. at 463 (affirming 37 F.P.C. at 550). When resolution of a question "depends on 'engineering and scientific' considerations," this Court "recognize[s] the relevant agency's technical expertise and experience, and defer[s] to its analysis." *Id.* at 463. Indeed, the Court concluded that passing "[j]udgment upon these conflicting engineering and economic issues is precisely" why FERC was created, and therefore deference is due "'so long as it cannot be said . . . that the judgment which [FERC] exercised had no basis in evidence and so was devoid of reason.'" *Id.* at 466.

Therefore, even though this Court declined "to approve or disapprove" the unity of electromagnetic response as an alternative ground for jurisdiction in *Florida Power & Light*, *id.* at 462-63, the principles of deference relied upon by the Court to decide that case support embracing the electromagnetic response approach to jurisdiction in this case.

II. THE STRUCTURE, OPERATION, AND HISTORICAL DEVELOPMENT OF THE ELECTRIC POWER SYSTEM.

A. Structure and Operation.

An electric power system consists of three principal divisions: *generation, transmission*, and *local distribution*. *See* Stevenson, *supra*, at 1.

Generation takes place at a power plant where a fuel such as coal, gas, oil, uranium or hydro power is used to spin a turbine which turns a generator to generate electricity.

Transmission lines connect the generating stations to the distribution systems (and also connect the entire utility power

system to other power systems). *Id.* Transmission takes place on a network — a configuration of power lines connected so that multiple paths exist between any two points (or nodes) on the network. ABB Power T&D Co., INTRODUCTION TO INTEGRATED RESOURCE T & D PLANNING 10 (1994). This ensures reliability: if any one line fails, there is an alternate route and power is (hopefully) not interrupted. *Id.* As a result of the network arrangement, energy flows every which way on the grid, depending on where the load (demand for electricity) and generation are at any given moment, with the energy always following the path (or paths) of least resistance. Transmission is conducted at extremely high voltages — up to a million volts — because high voltage is necessary to deliver power over any significant distance. The 120 to 240 volt output of the wall sockets in an American home is insufficient to move power more than a few hundred yards. ABB Power, *supra*, at 4.

In addition to moving electricity, the transmission grid is vital to the stability of the power system. Indeed, much of the capital investment in transmission systems has traditionally been driven by the need for stability rather than the need to move power. By ensuring firm electrical ties among all generators, the grid enables even far-flung generators to stay electromagnetically synchronized with one another, which enables the system to function smoothly as the electrical load fluctuates and to pick up load smoothly if any generator fails. *Id.* at 10-11.

The *local distribution* system begins at a substation where electricity is received from the transmission lines and stepped down to a lower voltage by transformers. Simultaneously, the power flow is split to send power to a number of primary feeder lines that lead to other transformers that again step down and feed the power to secondary service lines that in turn deliver the power to the utility's customers. ABB Power, *supra*, at 6-7. Unlike the network arrangement of a transmission grid, more than 99% of all local distribution systems are designed as *radial* systems. *Id.* at 18. Radial systems are *closed* — once power is transmitted to them, it is delivered to customers. Electricity is

not stepped up in voltage and put back on the transmission grid. Because there is only a single path between each customer and the substation, the route of power flow in a local distribution system is absolutely certain. *Id.* at 19. The consequence of this simplicity in design is that a radial feeder system is not as reliable as a network; if a falling tree takes down a feeder line during a storm there is no alternate route for power delivery. On the other hand, such an outage is isolated and affects only the customers served by that particular line; neighbors on a different radial line experience no blackout. *Id.* at 19-20.[11]

The most salient feature of a contemporary power system is *interconnection* — a group of individual utility company transmission networks that are themselves networked together. Transmission networks are connected by "tie-lines" over which companies share power. Energy may be bought and sold to economize: for example, if company X's electricity is less expensive to procure at a given time than Company Y's would be to produce, Y will buy electricity from X and have it transmitted over the grid. Energy may be bought when Company A cannot meet demand by itself: for example, if A depends heavily on hydroelectric power (as many western utilities do) and the region where A is located has been experiencing a drought that lowers river levels, or if A needs to take generating equipment off-line for repair or replacement.

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[11] Thus, transmission is distinguished from local distribution by higher voltage, network configuration, and function. ABB Power, *supra*, at 9-10. Order 888 contains a seven-factor test for distinguishing facilities used for local distribution from those used for transmission: (1) local distribution facilities are in proximity to retail customers; (2) are radial in character; (3) power flows into them but rarely, if ever, flows out; (4) power within the distribution system is not reconsigned to some other market; (5) power is consumed in a relatively confined geographic area; (6) meters are placed at the transmission/distribution interface to measure flows into the distribution system; and (7) distribution systems are of reduced voltage. Order No. 888, FERC Stats. & Regs. ¶ 31,036, 31,770, 61 Fed. Reg. 21,540 (May 10,1996).

Thus, many energy transfers on the grid are pre-arranged by agreement between the parties. But even these transfers are achieved by having the supplying utility ramp up its electrical generators and having the receiving utility either ramp its generators down or simply not interrupt the demand on the grid, with the effect that net power flow over the tie-lines is in the direction of the desired exchange. Thus, this type of exchange confirms, rather than refutes, the proposition that the grid is electrically unified.

Moreover, this describes operation of a power grid only when everything goes according to plan — which happens no more often in the electric power industry than it does in any other part of life. The utility control systems described by the PUCs "are not perfect devices, with the result that there are regularly occurring instances [of] . . . inadvertent interchange." Allen Wood & Bruce Wollenberg, POWER GENERATION, OPERATION AND CONTROL 380 (1996). When a utility gets too far out of line in consuming power beyond the power-sharing plan agreed upon with its neighbors on the grid, this is known as "leaning on the ties." *Id.* Thus, because the individual utility networks are connected by a tie-line "which permits a free flow of power and energy throughout the networks," all the contributing utilities "operate in parallel and are interlocked electromagnetically," and any given utility company on the interconnection "has no control over the actual transfers of electric power and energy with any particular electric system with which it is interconnected." *Florida Power & Light*, 37 F.P.C. at 549.

Another category of inadvertent exchange is a system disturbance — a transmission line goes down or a generator is tripped off-line suddenly and power automatically flows to the newly deficient network before intervention by a system operator is possible. Syed Nasar, ELECTRIC ENERGY SYSTEMS 319 (1996). In such emergencies, the rotor dynamics of the various electrical generators linked on the interconnection are uncontrolled. Olle Elgerd, ELECTRIC ENERGY SYSTEMS THEORY: AN INTRODUCTION 478-79 (1971).

Finally, energy flows across the tie-lines that interconnect separate utility networks in uncontrollable ways due to parallel or loop flows. The problem is that the "contract path" for the electrical transmission agreed upon by the buyer and seller in negotiating the transaction has nothing to do with the route by which the power actually flows. Electrical energy follows the path of least resistance on the grid. The flow of energy is therefore said to be on a different "loop" of transmission lines, which are parallel (electrically speaking, *not* geographically) to the nominal "intended" path. Thus, the exchange of power may have been planned, but the route (or routes) that the energy took across the tie-lines of the grid was not planned — nor could it have been. This form of electrical interchange is up dramatically in recent years due to the growth in energy market transactions spurred by the advent of deregulation.

The structural, engineering differences between network-configured transmission systems and radially configured local distribution systems have important implications. On a network, events cannot be isolated. A physical event anywhere on a grid — a downed transmission line, a failed relay switch, a large generator coming on line — affects every other point on the network.

Perhaps the most dramatic illustration of this was the Great Northeast Blackout of 1965. *See* Bob McCaw, *The Great Blackout*, POWER ENGINEERING 36A-36C (Dec. 1965). When a single relay at a power plant in Ontario, Canada was set incorrectly on November 9, 1965, the 300 megawatt load being carried on the line controlled by that relay was immediately dumped onto the other lines emanating from that plant and they all tripped out, even though they were not overloaded. The 1600 megawatts being carried by those lines into Ontario were suddenly dumped on the New York system, and the resulting power surge knocked out the main east-west transmission line and a series of cascading tripouts shut down seven units that had been feeding the Northeast grid. The consequent drain on systems to the south (New York City) and the east (New

England) caused the whole system to collapse. The remaining plants could not handle the demand and as their generators struggled to make up the lost supply of electricity, automatic safeties shut down those plants to save them from damage. Loss of the upstate power plants caused an immediate, convulsive reversal of energy flow: for example, New York City, which had been drawing 300 megawatts from the network, now was trying to power not only the City but much of the rest of the state. At the height of the evening rush hour, darkness descended as thirty million people in eight states plus eastern Canada were blacked out.

It is therefore undeniable that the entire transmission network of a given interconnection must be operated cooperatively as one big, synchronized system. The North American Electric Reliability Council (NERC) was created as a voluntary industry organization in response to the 1965 blackout, with the goals of preventing such events through improved communication and coordinating the industry response when such events occur. NERC exists precisely because of the inescapable interdependence of the electricity network.

B. Development of Transmission Systems Since 1935.

Both Enron and the State PUCs agree that when the FPA was enacted in 1935, electricity was essentially a local business. State PUCs Br. in No. 00-568, at 27; Enron Br. at 6. *See* J. Duncan Glover & Mulukutla Sarma, POWER SYSTEM ANALYSIS AND DESIGN 7 (1994) (utilities were isolated systems); Nasar, *supra*, at 319 (originally limited to radial feeder systems for single towns); Stevenson, *supra*, at 2-3 (individual, isolated systems). The parties also agree that in 1935 only a fraction of America's electric systems were interconnected across state lines and consequently the vast majority of electrical transmissions were entirely intrastate. Enron Br. at 7; State PUCs Br. as Resp. in No. 00-809, at 26 (over 80% of transmissions were intrastate). Indeed, the first instance of two large power systems actually

operating with an interconnection for a meaningful period of time did not occur until 1926, and even that operation was entirely intrastate. Nasar, *supra*, at 319. It is therefore unsurprising that interstate transmission was still in its infancy when Congress enacted the FPA in 1935.

As interconnection among neighboring utilities grew, *see* Glover & Sarma, *supra*, at 7-8, largely due to the pursuit of greater reliability and to technology that made transmission possible over longer distances with higher voltage, power companies isolated within a single state became virtually extinct. With the exception of some companies in Texas, *every* utility in the continental United States, coast-to-coast, is grouped into one of nine regions called Electric Reliability Councils that in turn constitute two huge interconnected networks: (1) Midwest and Eastern U.S. and (2) Rocky Mountains and Western. *See* Robert Sarikas, INTRODUCTION TO ELECTRICAL THEORY AND POWER TRANSMISSION 79-80 (1995). *All* transmission lines (outside the three states listed above) are connected to one of these two interstate grids. Order No. 888, at 31,781.

A map of the North American high voltage transmission system is included in Appendix A at A-1. If the transmission grid conformed to political borders, one could easily discern the boundaries of the 48 states. But as the second map at App. A-2 shows, without an overlay of the borders, a map of transmission lines is useless for defining even the American-Canadian frontier, much less the state borders. The transmission grid is interstate — indeed, inter*national* — and so is the electricity on that grid.

III. THE STATE PUCs MISUNDERSTAND THE PHYSICS OF ELECTRIC ENERGY AND HOW IT IS TRANSMITTED AND THEREFORE MISAPPLY THE FPA'S "ENGINEERING AND SCIENTIFIC" TEST FOR FEDERAL JURISDICTION.

Section 201(b)(1) of the FPA grants FERC jurisdiction over "the transmission of electric energy in interstate commerce," and

section 201(c) provides that "electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof." 16 U.S.C. §§ 824(b)(1) & 824(c). Accordingly, the issue of federal jurisdiction becomes primarily a question of physics and electrical engineering: is energy transmitted on an interconnected grid that spans state borders transmitted from one state and consumed outside it?

With the exception of transmissions on the electric grids isolated in the states of Hawaii, Texas, and Alaska, *all* transmissions are interstate because *all* transmission lines are part of either the "Midwest and Eastern" or "Rocky Mountains and Western" interconnections. *See* App. A-2. Those interconnections span multiple state boundaries, and every watt of power generated in their territory is fed onto a network where it becomes part of a single, synchronized, inherently multi-state, electromagnetic waveform, from which undifferentiated electric energy is drawn and consumed by customers in every state on that interconnection. The State PUCs' arguments to the contrary defy established principles of physics and electrical engineering.

1. The State PUCs insist that "[m]ost electricity used in the U.S. is generated in the state where it is used." State PUCs Br. in No. 00-568, at 5. The only support proffered for this assertion is several statistical reports describing energy use in New York, Florida, and Idaho. Those reports do not even purport to confirm the State PUCs' assertion, nor could they, since all three states are on multi-state interconnections and there is simply no telling where the energy generated in those states goes once it is on the grid. Those reports establish, at most, only that these states each generate as much power every year as they consume. That may make these states annually self-sufficient in some bookkeeping sense. But that does not change the fact that, in the day-to-day operations of the utilities in these states, they are continuously interconnected with a unified interstate network energized by a single electromagnetic waveform. From a financial or

transactional perspective, records are kept as to whether each utility is carrying its own weight and meeting its obligations under the complex power-sharing contracts that are a requirement for connection to the network. But from the perspective of physics and electrical engineering, once a company's generators are wired into the grid the energy on that interstate network cannot be differentiated in ownership or origin. Thus, simply to be a member of a multi-state power network is to participate in interstate commerce in electricity.

Indeed, both the Florida and Idaho reports cited by the PUCs reveal that those states are in fact "Net Importers" of electricity. Idaho State Electricity Profile (1998), U.S. Dep't of Energy, Table 1; Florida Reliability Coordinating Council, "2000 Regional Load and Resource Planning" 33 (July 2000). The very fact that these statistical tables record "net" figures for electrical exchange with sources in other states confirms that Florida and Idaho — like 45 other states — routinely transmit power to, and consume power from, other states.

Actually, Idaho is an egregiously poor example for the "self-contained states" point the PUCs are trying to make, because that state might well qualify as the poster child for interstate interconnections. Idaho is part of not one, but *four* different interstate electrical control areas. The function of a control area is moment-to-moment regulation of the energy on the control area's network through "instantaneous matching of generation and load so as to maintain constant frequency and synchronous time." Sarikas, *supra*, at 69. Control areas also maintain energy accounts for financially settling the energy exchanges that flow back and forth among the utilities that are members of the control area. From an engineering perspective, control areas are the electric power system's jurisdictional entities.

The problem for the State PUCs is that the political borders of the State of Idaho do not constitute such a control area. Instead, Idaho's power system is balkanized into four different control areas, each of which covers part of Idaho and parts of other states as well. The PacifiCorp West control area includes

one part of the western border of Idaho — along with parts of California, Oregon, Washington, and Nevada. *See* www.pacificorp.com/paccomp/. PacifiCorp East includes southeastern Idaho — and most of Utah and parts of Wyoming. *Id.* The Idaho Power control area includes most of the central parts of the state — as well as parts of Oregon and Nevada. *See* www.idahopower.com/company/facts.htm. Finally, the Bonneville Power Authority control area includes much of northern Idaho — as well as portions of Oregon, Washington, Wyoming, Nevada, Utah, California, western Montana, and eastern Montana (but not central Montana). *See* www.bpa.gov/corporate/KCC/ff/bpa_facts/page2.shtml.

Thus the moment-to-moment operations and energy transfers of any given electric company in Idaho are controlled in parallel *not* with the other utilities throughout Idaho, but with utility companies in that electric company's *control area*, which may encompass as many as *seven other states*.

2. The States assert (without citation to any authority) that "most energy passes from power plants to the retail customers who are first in line on transmission lines with suitable capacity." State PUCs Br. in No. 00-568, at 45 n.28. *See also id.* at 37 (same). Once again, the States rely on their erroneous model of "electrons" being "carried" here and there in discrete, traceable units, like drops of water in a pipeline. *Id.* at 45. The resulting fallacy is the assumption that, because electric energy is generated and electric energy is consumed within a state, this energy can be treated as though it were somehow identifiable as the *same* energy — as if it were somehow distinguishable from the rest of the undifferentiated electromagnetic wave that was electrifying the interstate grid at the moment the user flipped on his television set. Again, that is not how electricity works.

Unsurprisingly, the State PUCs' argument has already been rejected by this Court. In *Florida Power & Light*, the FP&L utility claimed that, even though it was on a grid that crossed into Georgia, it somehow knew that all of its wattage was exhausted

by its own nearby users (or those of a neighboring Florida utility) "before the point, further down the line, where Georgia's load intervenes." 404 U.S. at 462. The dissent accepted the utility's argument, 404 U.S. at 471-72 (Douglas, J., dissenting), but the majority did not. FERC's expert conclusion that energy from multiple, multi-state sources "commingles in a bus" at the interconnection and is then "transmitted in commerce" was sufficient to confer federal jurisdiction under the FPA. 404 U.S. at 463.

3. The PUCs offer no proof that the power they generate and transmit on an interstate network nevertheless is consumed solely by in-state customers. But nothing would change if they made such a proffer because this Court has already rejected such tracing efforts as misguided. In *Florida Power & Light,* FERC rebutted the theory of "point-to-point tracing" of alternating current electric power, noting that it was inappropriately based on "principles of direct current [DC] circuits with static power sources and with steady state power flows," and erroneously assumed power flow through an interconnection was "constant in value and direction." *Florida Power & Light Co.*, 37 F.P.C. at 551. Therefore, the theory did "not fully or accurately reflect . . . the physical reality" of an AC electric power system. *Id.* On appeal, this Court confirmed that, "'where the utility is a member of a combination of utilities and has continuous access to an integrated pool of interstate energy, the tracing of out-of-state energy is indeed difficult, burdensome, and perhaps impossible.'" 404 U.S. at 468 n.18.

4. The PUCs contend that to establish federal jurisdiction over interstate transmissions, "FERC would have to show that essentially every electron used by a retail customer in each state (other than Hawaii, Texas, and Alaska) is generated in a different state." State PUCs Br. in No. 00-568 at 45 n.27. But as explained above, electricity is not a stream of discrete electrons that travel to consumers to be individually consumed; it is not

electrons that flow through transmission wires, but electric *current*. And the current generated by all the power plants hooked up to a given multi-state interconnection energizes the entire transmission grid with one single, continuous electromagnetic waveform that by its very nature moves in interstate commerce.

5. The States argue that "all generation on the interconnected grid does not serve all customers on the grid," citing B.M. Weedy & B.J. Cory, ELECTRIC POWER SYSTEMS 175 (1998). State PUCs Br. as Resp. in No. 00-809, at 26. Professors Cory and Weedy were discussing control area operations and the management of power and frequency. But the very existence of control areas negates the States' argument. If energy flows on the grid were as discrete and containable as the States contend, then there would not be a need for control area operators to balance supply and demand for their region or to monitor both planned and inadvertent energy flows on the interfaces between control areas.

Indeed, the cited section from Weedy and Cory stresses the fluid interdependence of networked systems, by pointing out that if the electrical load (demand) changes in one company's system, the frequency of the electromagnetic wave on that system and on every other interconnected control area changes. Thus, as the authors demonstrate, if the power system in New York City were isolated from external supplies of electricity, the frequency of the electricity on the system would rapidly decline from the required 60 cycles per second and the City would be blacked out within minutes. Weedy & Cory, *supra*, at 174.

The State PUCs' premise that state power systems are self-contained explodes upon examination of the geographic outline of almost any control area in the nation, because *electric power system control areas do not respect state borders*. As explained above, Idaho is carved up among four control areas, each of which spreads into two or more other states. The PJM Interconnection spans Pennsylvania, New Jersey, and Maryland,

yet excludes a large area in central Pennsylvania. *See* www.pjm.org. The American Electric Power control area snakes like a gerrymandered congressional district through the States of Michigan, Indiana, Ohio, Kentucky, Tennessee, Virginia, and West Virginia. *See* www.aep.com/about/territory.htm. Thus, it is simply impossible to contain electricity on the grid within state borders because that electricity is generated, transmitted, and managed within control areas that are not drawn in accord with state boundaries.

6. The PUCs ultimately retreat and admit that the proposition that all transmissions "affect the entire grid" is "arguably accurate, from a theoretical standpoint" and is "technically correct." State PUCs Br. as Resp. in No. 00-809, at 25. The PUCs then fall back on the contention that any such effect is "inconsequential" because the "reaction of distant electrons in the grid is immeasurable." *Id.* The PUCs offer this example: "When a customer in New York City turns on a 60 watt lightbulb, the energy required to light the bulb is supplied by increases in output of nearby New York City generators." *Id.*

It is true that a lightbulb turned on in New York City will not have an appreciable effect on a generator very far away. It is also true that it will have almost no effect on even the closest generator. Indeed, a lightbulb or any other small device will have no effect on anyone except for the people in the room. But any event of note, such as a large industrial plant coming on line, or a large building such as the World Trade Center turning on all of its equipment, will ripple across transmission lines to affect generators both near and far, within New York and without.

7. The PUCs' concession that the premise of unity of electromagnetic response on a grid is "technically correct" is fatal to their cause, and the impact of their concession is not diminished by their qualifier that the ripple effect on a network is supposedly "inconsequential." For it is well established that there is no de minimis exception to federal jurisdiction over

interstate transmissions, no minimum threshold of megawatts. "We do not find that Congress has conditioned the jurisdiction of the Commission upon any particular volume or proportion of interstate energy involved, and we do not . . . supply such a jurisdictional limitation by construction." Connecticut Light & Power Co., 324 U.S. at 536 (jurisdiction based on "one-fifth of one per cent of all the energy received and generated" by the company throughout entire state was transmitted interstate). "If [Congress] thinks the Commission is over-extending its attention to trivial situations it has ready means of control in its hands." *Id.* at 536.

8. The States retreat even further, falling back on the contention that, even if a transmission anywhere on a network affects the unified, interstate electromagnetic wave, "these indirect reactions do not occur in radial (direct line) delivery systems designed to serve retail load." State PUCs Br. in No. 00-568, at 45 n.28. But this proves *our* point: the PUCs have confused transmission on an interconnected, *interstate network*, where events cannot be isolated (and where FERC has jurisdiction), with *local distribution* on a *radial delivery system*, where events are isolated by the system's design (and where the states have jurisdiction). *See Connecticut Light & Power Co.*, 324 U.S. at 518, 530 (federal jurisdiction follows interstate electric flow, and therefore reaches "interstate power pool" existing on network among states, but does not reach systems of "local distribution").[12]

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[12] The PUCs' twice cite Sarikas, *supra*, at 70, 82, for the proposition that locally generated electricity is consumed locally even when transmitted on a network with interstate connections and that local events have no impact elsewhere on a network. *See* State PUCs Br. in No. 00-568, at 45-46 n.28; State PUCs Br. as Resp. in No. 00-809, at 25. But the quoted passage states only that a utility "that is generating only to meet its own requirements will have zero net interchange and will not be a net seller or buyer." True enough, but so what? The very fact that the passage refers to *net* interchanges indicates that *the utility is engaged in interchange*

IV. The State PUCs Misunderstand Power System Structure and Operation and Therefore Misapprehend the Division of State and Federal Jurisdiction Under the Federal Power Act.

1. The PUCs confuse transmission with local distribution. For example, they purport to refute the proposition that *transmission* falls within federal jurisdiction by emphasizing that, on the contrary, "'electric current *distributed* is subject exclusively to the jurisdiction of the State.'" State PUCs Br. as Resp. in No. 00-809, at 11 (emphasis added). They answer the statement that events on an interconnected *transmission network* cannot be isolated with the pointed rejoinder that such "indirect reactions do not occur in *radial* (direct line) *delivery systems*." State PUCs Br. in No. 00-568, at 45 n.28 (emphasis added). But as explained on page 25 above, network transmission and radial distribution are fundamentally different systems, and FERC is asserting jurisdiction only over interstate transmission, in accord with § 201(b)(1) of the FPA, and not over local distribution.

2. The State PUCs try to rewrite the vocabulary for electric regulatory discourse by introducing new concepts of "retail transmission" and "wholesale transmission." *See, e.g.*, New York PUC Cert. Pet. at 2; State PUCs Br. as Resp. in No. 00-809, at 4, 5, 10, 17, 24, 25, 26, 27; State PUCs Br. in No. 00-568, at i, 26, 28. The States apparently believe that smuggling the term "retail" into the case in association with "transmission"

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transmissions on the network, but that at the end of the relevant accounting period the *net* exchange is zero. The fact that the utility may thus be "self-sufficient" in some accounting sense and in some time frame, does not negate the fact that, by virtue of being interconnected, it constantly exchanges power on an interstate network, one moment taking power from the grid, the next moment adding power to the grid. Dr. Sarikas points out in the same section that every utility in America, outside Texas, Hawaii, and Alaska, is part of an interstate transmission network. *See id.* at 79-80.

will aid them in their effort to persuade this Court that Congress ousted FERC from the jurisdiction over interstate transmission explicitly conferred by FPA § 201(b)(1) by, supposedly, "implicitly recogniz[ing] the states' jurisdiction over retail transmission" in § 206(d). State PUCs Br. as Resp. in No. 00-809 at 6. *See also id.* at 7, 26. Perhaps the PUCs' hope is that "retail transmission" will sound inherently local and therefore appropriate for state rather than federal regulation.

Of course, the term "retail transmission" does not appear in the FPA, which is why the PUCs refer to the statute's supposed preservation of this power as "implicit," and why the PUCs repeat their newly coined term frequently in an effort to make it sound familiar. But the only distinction the FPA makes with respect to transmission is between in*ter*state and in*tra*state, with federal jurisdiction over the former and state jurisdiction over the latter. *Compare* § 201(c) *with* §201(b)(1). "Wholesale" and "retail" are transactional terms, which is why the FPA uses them only to distinguish types of *sales*. *See* §§ 201(b)(1), 201(d). These terms have no relevance to the transmission of electricity.[13]

Unable to locate their new vocabulary in the statute, the State PUCs attempt to give it respectability by purporting to derive the terms "retail transmission" and "wholesale transmission" from the Glossary of Terms Task Force of the North American Electric Reliability Council (1996). *See* Cert. App. Q to the NY Pet. at Q-3, Q-4. Appendix Q states (at Q-1 n.1) that the terms it sets forth have been "selected and adapted" from the official NERC Glossary of Terms, but neither of the terms in Appendix Q ("retail transmission service" and "wholesale transmission service") appears anywhere in the actual

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[13] Perhaps the wholesale/retail distinction for sales had some utility as shorthand in 1935 for discussing transmission and distribution, because at that time wholesale sales corresponded to transmission and retail sales to local distribution. *See* NY Cert. App. C-27 (opinion below). But that neat correspondence no longer applies in the 21st century. *See* C-28.

NERC Glossary. Indeed, there is no term even referring to "retail" or "wholesale" in any way. The PUCs' portrayal of the structure of the electric power system and its implications for federal jurisdiction is therefore not only unpersuasive, it is utterly baseless.

3. The PUCs argue that, because the states regulated "retail transmission" in 1935, and because Congress intended the FPA to preserve pre-existing state regulation, the states continue to have jurisdiction over "retail transmission." In the first place, as explained above, what the FPA reserved to states was regulatory power over "the transmission of electric energy in *intrastate* commerce." FPA § 201(b)(1) (emphasis added). The category of "retail transmission," which the PUCs describe as far broader than "intrastate" transmission, is the PUCs' own invention.

The existence of section 201(b)(1) of the FPA is awkward for the PUCs' argument, so they instead invoke section 201(a), which states that "Federal regulation [shall] extend only to those matters which are not subject to regulation by the States." State PUCs Br. as Resp. in No. 00-809, at 6. *See also id.* at 5, 12; State PUCs Br. in No. 00-568, at 27-28. But that section likewise does not mention "retail transmission." The PUCs therefore devote most of their energy to arguing that the legislative history of the FPA is replete with congressional reassurances that state jurisdiction would be preserved whenever possible and that the new federal jurisdiction would be limited to those matters which cannot effectively be regulated by the states themselves. State PUCs Br. in No. 00-568, at 17-26; State PUCs Br. as Resp. in No. 00-809, at 7-12. Therefore, we are told, reading the FPA to give control over "retail transmission" to FERC would be inconsistent with the FPA's legislative purpose.

But there is no inconsistency at all. Section 201(a) formally "declare[s]" that "Federal regulation of matters relating to . . . the transmission of electric energy in interstate commerce . . . is necessary in the public interest." The next section then unambiguously grants FERC jurisdiction over "interstate"

transmission while reserving to the states most jurisdiction over "generation," "local distribution," and "intrastate" transmission. FPA § 201(b)(1). Thus those local matters subject to effective regulation by the states are still within the state bailiwick, whereas *interstate* transmission, plainly beyond *any single state's* control, is to be regulated by FERC.

When enacting the FPA in 1935, Congress could give FERC jurisdiction over all interstate transmission and simultaneously proclaim that the new statute would not, in fact, erode state regulatory power, *because in 1935 there was hardly any interstate transmission.* The federal government received jurisdiction only over what the states could not regulate effectively — *which in 1935 was not much*, given that the nation's electric power industry was almost entirely local and isolated, and electric transmission was overwhelmingly *intra*state. *See supra* pages 17-18. Thus, in 1935 the regulatory jurisdiction that the FPA conferred upon FERC constituted a relatively small portion of the total regulatory power exercised over the electric power industry.

4. The State PUCs would like to pretend that the world has not changed since 1935. They contend that increased "interconnections since 1935 are not relevant to the states' jurisdiction over retail transmissions." State PUCs Br. as Resp. in No. 00-809, at 26. Such changes, they argue, "do not alter the FPA's language." *Id.* The PUCs accuse FERC of trying to rewrite the FPA's jurisdictional assignments to invade the regulatory sphere reserved to the states.

There has been no change in the FPA's text or interpretation. The jurisdictional lines drawn in the FPA are still the same: the states get generation, distribution, and intrastate transmission, while FERC gets interstate transmission. What has happened is that the electrical system being regulated has changed. It has shifted underneath the FPA's jurisdictional lines as high-voltage interstate transmission wires have grown like new nerve fibers across the American landscape. Interconnected networks and

interstate transmissions were few and far between in 1935; today every high-voltage transmission line in the continental U.S. (outside Texas) is wired into one of the two vast interstate grids. Thus the electrical transmission system has grown away from the state regulatory territory defined by the FPA and has grown into federal territory.

As the States point out, Congress foresaw this trend to increased interstate interconnections when it drafted the FPA in 1935. State PUCs Br. as Resp. in No. 00-809, at 26. Congress accordingly defined FERC's jurisdiction in terms that would allow it to match the need for effective regulation even as the industry changed. By unambiguously providing for federal jurisdiction over "the transmission of electric energy in interstate commerce," FPA § 201(b)(1) — rather than retail transmission, wholesale transmission or some other subset of interstate transmission — Congress ensured that no gaps would develop in federal jurisdiction as the transmission system evolved. In 2001, even more than in 1935, federal regulation of this interstate commerce "is necessary in the public interest." FPA § 201(a).

CONCLUSION

For the reasons given above, *Amici curiae* urge this Court to uphold federal regulatory jurisdiction over transmissions on the nation's interconnected, multi-state electricity networks.

Respectfully submitted,

CHARLES J. COOPER
Counsel of Record
BRIAN STUART KOUKOUTCHOS
COOPER & KIRK, PLLC
Suite 200
1500 K Street, N.W.
Washington, D.C. 20005
(202) 220-9600

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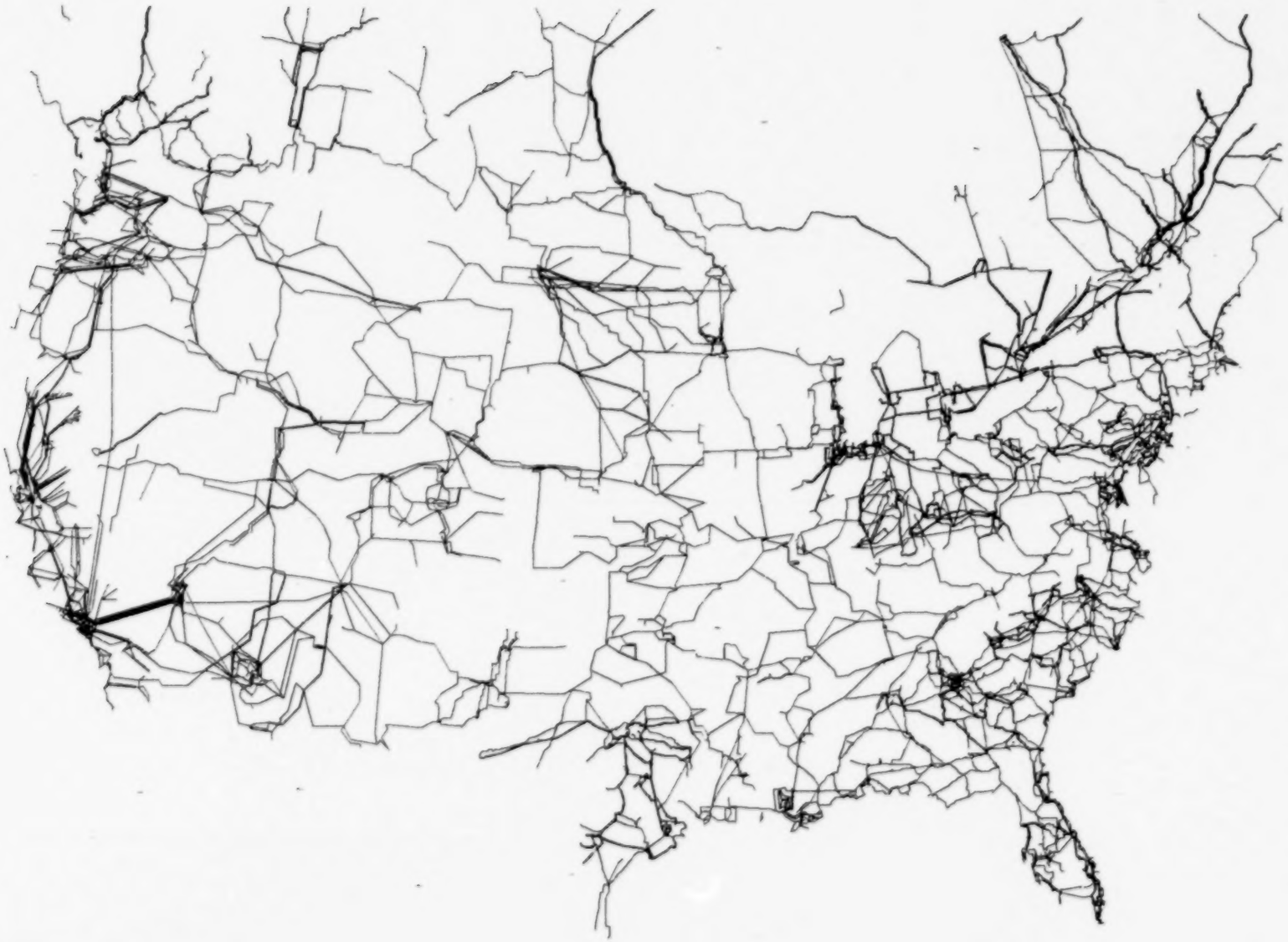
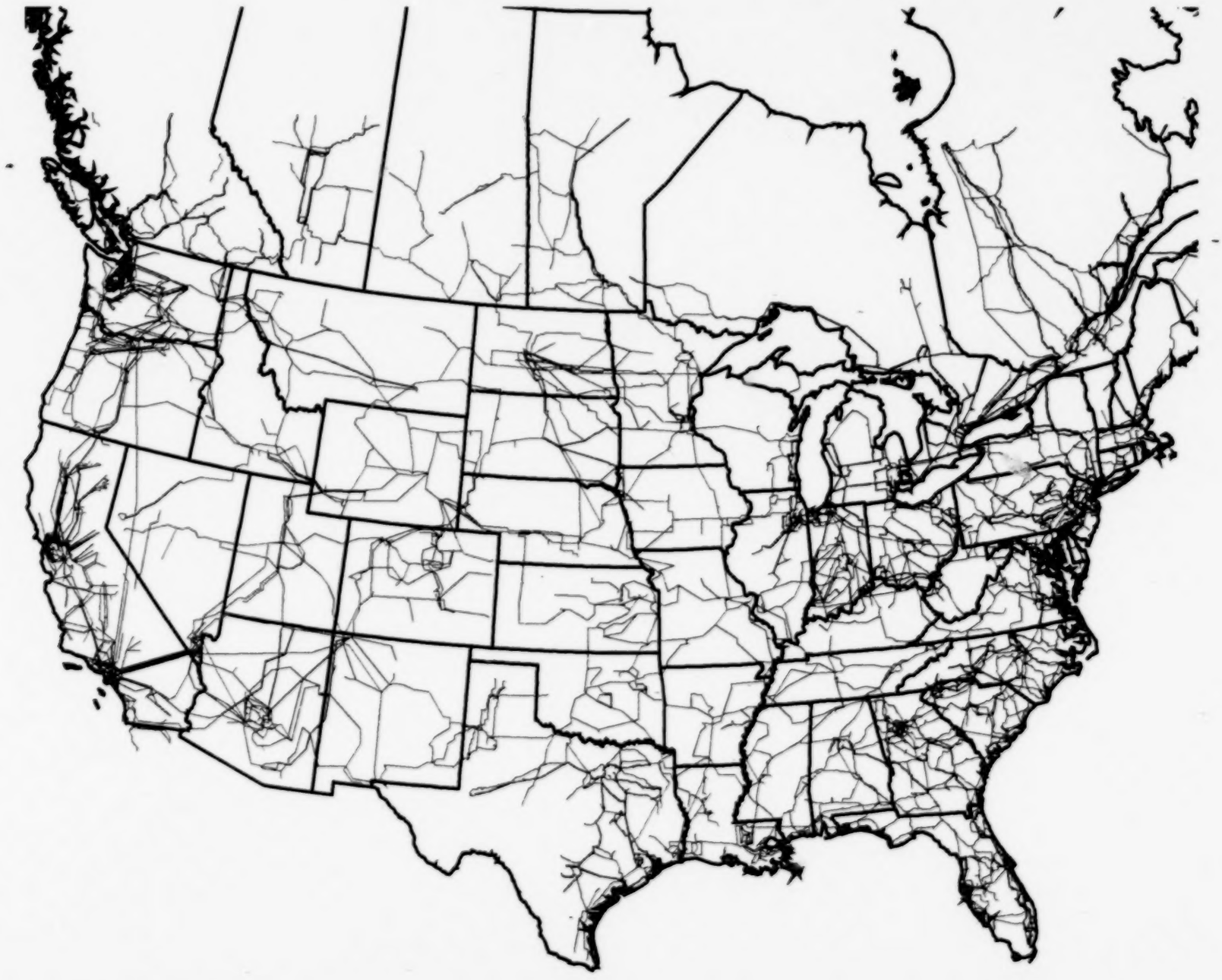
APPENDIX A

High Voltage Transmission System: USA and Canada



High Voltage Transmission System:
USA and Canada with State and Provincial Boundaries



AMICI CURIAE

FERNANDO L. ALVARADO is professor of Electrical and Computer Engineering at the University of Wisconsin at Madison. A professional engineer and computer scientist, Professor Alvarado is an established leader in technical policy elements of the electric power industry. His areas of expertise include policies for market design and power system operation and power system security and stability issues in interactions between power systems. He is the author or coauthor of more than 80 technical journal publications, books and book chapters, and almost 200 conference presentations and reports. Professor Alvarado is a member of the IEEE, the Society for Computer Simulation (SCS) and the Society for Industrial and Applied Mathematics (SIAM), as well as vice chairman of the IEEE Energy Policy Committee. He earned his Bachelor of Science in Electrical Engineering at the National University of Engineering in Lima, Peru, his Master of Science in Electrical Engineering from Clarkson College of Technology, and his Ph.D in Computer, Information and Control at the University of Michigan at Ann Arbor.

CLINT ANDREWS, P.E., Ph.D., is an assistant professor in the Bloustein School of Planning and Public Policy at Rutgers University. He was educated at Brown and MIT as an engineer and planner. Previous experience includes working in the private sector on energy issues, helping to launch an energy policy project at MIT, and helping to found a science policy program at Princeton. He is Vice President of the Society on Social Implications of Technology of the Institute for Electrical and Electronics Engineers (IEEE); he is a member of the IEEE-USA Energy Policy Committee and the IEEE Power Engineering Society System Economics Committee, a past consultant to numerous electric utilities and their regulators, and an active energy policy researcher. He has authored three books. In 2000, he received a *3rd Millenium Medal* from the IEEE for contributions at the interface of technology and society.

SHIMON AWERBUCH has 30 years of experience in finance, regulatory economics, energy economics and economic development, involving the private sector and all levels of government. Dr. Awerbach has served as Chief of Economic and Policy Studies for the Utility Intervention Office of the NY State Executive Department. He has also served with the Management Consulting Service of Ernst & Young and held policy positions with the NY State Governor's Economic Development Board and the NY State Legislature. He has contributed over 50 articles to such journals as the *American Economic Review*, *Journal of Regulatory Economics* and is a member of the Editorial Board of *Energy Policy*. He is the co-author of *Independent Transmission Companies: Unlocking the Benefits of Electricity Restructuring* (PUR, November 1999) and the co-editor of *The Virtual Utility: Accounting, Technology and Competitive Aspects of the Emerging Industry* (Kluwer, 1997). He has also presented his research findings to delegates of the *United Nations Commission on Sustainable Development* in New York and has testified extensively in regulatory proceedings. Dr. Awerbach received his Ph.D. in Urban-Environmental Studies from Rensselaer Polytechnic Institute.

JUDITH B. CARDELL is an electrical engineer and policy analyst with 10 years of experience in modeling and analyzing electric power systems and electricity markets. Currently a Senior Associate with Tabors Caramanis & Associates, Dr. Cardell also spent several years as an economist and engineer for FERC. Dr. Cardell previously worked at the MIT Laboratory for Electromagnetic and Electronic Systems, and was a graduate instructor at MIT for power systems and energy policy courses. A member of the IEEE's Energy Policy Committee, Dr. Cardell has published articles on energy policy and electric market modeling. Dr. Cardell earned her Ph.D. in Technology Management and Policy from MIT's Department of Electrical Engineering and Computer Science.

BRIAN CORY is Professor Emeritus in Electrical and Electronic Engineering at Britain's Imperial College in London, where he taught for almost 40 years until 1993. Dr. Cory's research interests have been focused on virtually all aspects of electrical energy supply, including both operating systems issues as well as policy issues in the deregulation and privatization of Britain's electricity industry. In the last five years alone, he has published close to a dozen professional journal articles on topics ranging from the pricing of electricity transmission and distribution to optimizing pumped storage generation, as well as a critical review of Great Britain's reorganized electricity supply industry and a proposal for neural-network based methods for evaluating power system voltage stability.

PETER CRAMTON is Professor of Economics at the University of Maryland and President of Market Design Inc. For several electric utilities, Professor Cramton has led the auction designs for generation asset divestiture, standard offer service, and NUG entitlements under power purchase agreements. He has advised ISO New England on the design of New England's wholesale electricity market. He has also advised numerous e-commerce market makers on market design for business-to-business trading. He has served as an auction advisor in spectrum auctions for many companies worldwide, as well as the FCC, the U.S. Department of Justice, and several foreign governments. Before joining the University of Maryland faculty in 1993, he was an Associate Professor at Yale University and a National Fellow at the Hoover Institution at Stanford University. He has published numerous articles on auction theory and auction practice in major journals. Professor Cramton received his B.S. in Engineering from Cornell University and his doctorate in Business from Stanford University.

DAVID HAYWARD is an electrical engineer with a long career in the electric utility industry, specializing in power systems operation. Mr. Hayward worked at New England Electric System for close to 40 years, where he held a number of key positions in bulk power system operations. He worked as a Power System Dispatcher, then spent several years doing long range system planning and performing transmission network analysis studies. He served on the committees that analyzed the 1965 Northeast Blackout. Mr. Hayward is a Senior Member of IEEE and has served on a number of regional and national IEEE committees. He is a former Chairman of the Current Operating Problems Subcommittee (COPS) and a former member of CIGRE. Mr. Hayward has a BS in Electrical Engineering from Tufts University and is a graduate of the Greater Boston Executive Program at the MIT Sloan School.

ERIC HIRST is an independent consultant focusing on issues related to restructuring the U.S. electricity industry. He holds a doctorate in Mechanical Engineering from Stanford University. For 30 years (1970 through 2000) he worked at Oak Ridge National Laboratory, rising to the position of Corporate Fellow, a distinction shared by only 1% of the lab's technical staff. He has published almost 500 articles in the technical and semi-technical literature related to energy efficiency, utility resource planning, transmission adequacy and planning, generation adequacy, system operations, wholesale markets, and other issues related to the changes underway in the U.S. electricity industry.

JOHN B. HOWE is Vice President of Electric Industry Affairs for American Superconductor Corporation, a leading developer and manufacturer of superconductor technology for the electric power industry. Previously, he served as Chairman of the Massachusetts Department of Public Utilities (now the Department of Telecommunications and Energy), where he

spearheaded early stages of the effort to restructure and introduce retail competition to the state's regulated energy industries. Mr. Howe was also formerly a Vice President with U.S. Generating Company (now PG&E Generating Company). He has held leadership positions in the National Association of Regulatory Utility Commissioners, the New England Conference of Public Utility Commissioners, and several national and regional independent power industry organizations. He holds a B.A., Magna Cum Laude in Political Science from Amherst College and a Master of Arts in Law and Diplomacy, with a concentration in Energy and Resource Economics, from Tufts University's Fletcher School of Law and Diplomacy.

JAMES L. KIRTLEY is Professor of Electrical Engineering at MIT, where he has specialized in the development and analysis of electric machinery for 30 years. He is also Vice President and Chief Scientist at SatCon Technology Corporation, and has held positions with the Swiss Federal Institute of Technology, General Electric and Raytheon. A Fellow of the Institute for Electrical and Electronic Engineers, Dr. Kirtley is Editor in Chief of IEEE's Transactions on Energy Conversion and was the recipient of IEEE's Third Millennium Medal in 2000. He has published 45 professional journal articles, numerous conference papers, and been awarded 17 U.S. patents. Dr. Kirtley received his undergraduate, masters, and doctoral degrees in Electrical Engineering from MIT.

RALPH D. MASIELLO holds a doctorate in Electrical Engineering from the Massachusetts Institute of Technology where he worked on some of the first applications of modern control and estimation theory to electric power systems, as well as state estimators for Transmission Operations. Since then, Dr. Masiello has acquired over 20 years of experience in Transmission and Distribution Operations, having been involved in the implementation of control systems at many of North

America's largest utilities. In addition he has assisted in the design and set up of deregulated energy markets across the United States and around the world. He is currently Senior Vice President of Caminus Corporation, a leading provider of software solutions and strategic consulting to entities participating in competitive energy markets. He was formerly the global Business Unit manager for Energy Information Systems for ABB, as well as marketing manager for ABB Information Systems Division, and General Manager of ABB's Systems Control Division in Santa Clara. Dr. Masiello has been an adjunct professor at the University of Minnesota and lectured at University of California at Berkeley, the University of Arizona, and the University of Wisconsin. He is a Fellow of the IEEE and has held several committee, advisory and editorial positions within IEEE and authored numerous technical papers.

HYDE M. MERRILL is the founder of Merrill Energy LLC, which provides advanced risk, engineering, and economic analyses for participants in modern energy markets. He is currently leading a major study of power plant reliability and market behavior for a US ISO. He has advised the Peruvian Tariff Commission on transmission planning, standards, economic and institutional issues associated with competitive power markets, as well as being a member of an international consortium guiding the creation of a power pool in Southern China. Dr. Merrill organized a team that assessed market risks in four US regions, as well as advising on a Quebec commission charged with investigating the massive power losses in the Province. Dr. Merrill was the executive chairman of the Power Industry Computer Applications (PICA) Policy Committee for four years, and is currently a fellow of IEEE. He is the author of more than 70 technical publications on the power industry. Dr. Merrill holds an undergraduate degree in mathematics from the University of Utah and a Ph.D. in electrical engineering from MIT.

TIMOTHY DOUGLAS MOUNT is professor at Cornell University in the Department of Applied Economics and Management. His research areas include market power and price volatility in restructured markets for electricity, alternative auction institutions for electric power markets, as well as global environmental economics. Among other societies, he is a member of the International Association of Energy Economics, American Statistical Association, and Association of Environmental and Resource Economists. Professor Mount has published numerous articles on the power industry as well as environmental and agricultural economics. He received his doctorate in agricultural economics from the University of California at Berkeley.

SHMUEL S. OREN is Professor of Industrial Engineering and Operations Research at the University of California at Berkeley. With a doctoral degree from Stanford University in Engineering Economic Systems, Dr. Oren's research has focused on electric power system economics, and in particular on optimization and pricing strategies. In addition to his position at Berkeley, Dr. Oren has served as an expert consultant to numerous agencies, research institutes, and private entities including EPRI, SRI International, Niagara Mohawk Power Corporation, Entergy, and the Texas Public Utility Commission. He is a Senior Member of IEEE's Power Engineering Systems Society, as well as a member of the Institute for Operations Research and Management Science (INFORMS), the International Association of Energy Economists (IAEE), and the Mathematical Programming Society. Dr. Oren serves on the editorial boards of both INTERFACES and ENERGY ECONOMICS, and has published dozens of professional articles in his field, covering such topics as transmission congestion, flow-based transmission rights, generation unit commitment methods, and market pricing methodologies.

MICHAEL H. ROTHKOPF received his doctorate in operations research from MIT in 1964, and has been a professor of management and operations research at Rutgers University since 1988. He has served as the senior scientist as Lawrence Berkeley Laboratory, as well as leading their energy analysis program. His research and professional interests of long standing include models of markets and of competitive bidding, applications of operation research, and energy economics. Professor Rothkopf has edited a book on the power generation-unit commitment problem. In addition, he has written over 50 papers that have appeared in archival journals. Professor Rothkopf is a member of the Institute for Operations Research and Management Science, International Association of Energy Economists and American Economic Association. In addition, he was Editor-in-Chief of *Interfaces* from 1993 to 2000, and area editor for Operations Research Practice for the Journal Operations Research from 1984 to 1993. Professor Rothkopf is also a part-time consultant for FERC.

ROY J. SHANKER received his doctorate in industrial administration from Carnegie Mellon University in 1975. Dr. Shanker has been an independent consultant since 1981, providing management and economic consulting services in natural resource-related industries, particularly in the electric and natural gas utilities. In this capacity he currently serves on the Energy Markets Committee, the Transmission Expansion Advisory Committee and the Tariff Committee of the Pennsylvania Maryland and New Jersey (PJM) Office of Interconnection. Dr. Shanker also serves as a member of the New York Independent System Operator Technical Information Exchange Committee and participates on the NYISO Business Issues Committee, the Scheduling and Pricing Working Group, the Market Structure Working Group and several other working groups supporting the New York wholesale electric market.

THOMAS R. SCHNEIDER is a principal in the consulting firm of TRSenergy in Portola Valley, CA, specializing in technology evaluation and product positioning in restructured electricity markets, in addition to the development and implementation of technology acquisition strategy. From 1987 to 1997 Dr. Schneider was the executive scientist at the Electric Power Research Institute in Palo Alto, California, where he conceived and led institute efforts to sponsor fundamental and novel research in power systems engineering, as well as identifying the importance of power-industry restructuring on power system operations and reliability. In addition to numerous other appointments in the power industry, Dr. Schneider is currently the Chairman of the IEEE-USA Energy Policy Committee, where he served as Vice Chairman from 1998 to 2000, and a member of the IEEE Technology Policy Council. Dr. Schneider has contributed extensively to books on the power industry, proceedings and congressional testimony, and holds a Ph.D. in Physics from the University of Pennsylvania.

RICHARD TABORS is an engineering economist and scientist with over 30 years of domestic and international experience in energy systems planning and pricing. Dr. Tabors is President and founder of Tabors, Caramanis and Associates (TCA), an engineering and economics consulting firm specializing in policy development, business planning and technical analysis in the energy and utility sectors in the United States and internationally. He is also Senior Lecturer in Technology and Policy at Massachusetts Institute of Technology and has provided testimony and worked with clients throughout the country. His work with coauthors Fred C. Schweppe, Michael Caramanis and Roger Bohn published in SPOT PRICING OF ELECTRICITY is recognized as one of the theoretical foundations of electric industry pricing and restructuring. Dr. Tabors earned his undergraduate degree from Dartmouth College, and his doctorate from the Maxwell School at Syracuse University. He

is co-author of 5 books and over 100 professional articles and reports. He is a member of the IEEE and the International Association of Energy Economists.

ROBERT J. THOMAS is Professor of Electrical Engineering at Cornell University, where he specializes in power systems analysis and in particular the analysis and control of linear and nonlinear continuous and discrete time dynamical systems, complex networks, and applications of these to large-scale electric power systems. He is also currently the Director of the Power Systems Engineering Research Center (PSERC), a National Science Foundation Center and a Steering Committee Member for the Consortium for Electric Reliability Technology Solutions (CERTS). Dr. Thomas' affiliations and awards are far too numerous to list in full, but have included a variety of memberships and positions with the USDOE Secretary of Energy's Power Outage Study Team, the Institute for Research and Education for Electric Power, the Edison Electric Institute, and Drexel University's Department of Electrical and Computer Engineering Advisory Committee. He is a member of the Board of the IEEE and Chair of the IEEE Technology Policy Council. He has published approximately 60 professional articles and served as Editor for a number of prestigious technical journals. Dr. Thomas received his undergraduate, masters, and doctoral degrees in Electrical Engineering from Wayne State University.

LEE WILLIS is a registered professional electrical engineer with 30 years of experience in the electric power industry, specializing in transmission and distribution systems issues. Currently Vice President of Technology and Strategy at ABB Consulting, he has held executive positions with ABB Inc as Vice President of Distribution Systems, Director of Technology for Distribution Automation, and as an Institute Fellow at ABB's R&D Lab. He has also held positions in transmission and distribution at Westinghouse Electric and Houston Lighting and

Power. He is a Fellow of the IEEE, a member of the National Research Council, and the editor of the Power Engineering Series for Marcel Dekker Publishers of New York. He is the author or coauthor of 47 engineering journal articles, and five books including the POWER DISTRIBUTION PLANNING REFERENCE BOOK, SPACIAL ELECTRIC LOAD FORECASTING, and DISTRIBUTED POWER GENERATION–PLANNING AND EVALUATION. He earned his undergraduate and master's degrees in electrical engineering from Rice University.

BRUCE F. WOLLENBERG has been a professor in the Electrical Engineering Department at the University of Minnesota, Twin Cities, since 1989. Prior to his appointment, he worked at Control Data Corporation's Energy Management System Division, where he was responsible for the development of Artificial Systems Applications. He consulted on advanced research projects in energy management system application software, and he also participated in the power system operator training simulator project for the Electric Power Research Institute. Professor Wollenberg's current interests involve the development of large scale network solution algorithms using vector processing supercomputers, the extension of traditional power system control techniques to incorporate spot pricing algorithms and distributed computer technologies, as well as the application of expert systems to enhance the information presented to power system operators using real time computers.

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In The

Supreme Court of the United States

People of the State of New York and the Public Service Commission of the State of New York, et al.
Petitioners,

v.

Federal Energy Regulatory Commission, et al.,
Respondents.

Enron Power Marketing, Inc.,
Petitioner,

v.

Federal Energy Regulatory Commission, et al.,
Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

BRIEF FOR THE STATE PUBLIC SERVICE COMMISSIONS AS RESPONDENTS ON THE MERITS IN 00-809

Lawrence G. Malone *
General Counsel
Jonathan D. Feinberg
Carl F. Patka
Diane T. Dean
Assistant Counsel
Public Service Commission
of the State of New York
Three Empire State Plaza
Albany, New York 12223-1350
(518) 474-2510

* Counsel of Record

BECKER GALLAGHER LEGAL PUBLISHING, INC.
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QUESTION PRESENTED IN NO. 00-809

Whether the District of Columbia Circuit correctly affirmed a Federal Energy Regulatory Commission (FERC) decision that it lacked jurisdiction under the Federal Power Act (FPA) subchapter 2, 16 U.S.C. §§ 824, et seq., to regulate the transmission of electric energy "bundled" (i.e., combined) with retail electricity?

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PRELIMINARY STATEMENT

Enron[1] challenges FERC's[2] conclusion that FERC lacks jurisdiction to regulate bundled retail transmission service. In effect, it claims that FERC has misread the FPA since its enactment in 1935.

Enron's position is baseless. The 1935 Congress denied FERC jurisdiction of all elements of retail service (FPA § 201), which included the delivery of energy. Public Utility Holding Companies, Hearings on H.R. 5423 before the House Committee on Interstate and Foreign Commerce, testimony of FERC Solicitor DeVane ("DeVane") at 556. The 1992 Congress, in enacting FPA § 212(h) (discussed below) reaffirmed state jurisdiction over retail transmission and left decisions on whether to allow retail competition to the states.

A. Enactment Of The Federal Power Act

In 1935, Congress passed the FPA. Its purpose was to fill a jurisdictional gap created by a Supreme Court decision barring states from regulating rates of wholesale energy sold across state lines. Public Utilities Comm'n of Rhode Island v. Attleboro Steam and Electric Co., 273 U.S. 83, 89 (1927). Because, with the absence of state regulation, there was no regulation of interstate sales, Congress filled this

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[1] "Enron" refers to Enron Power Marketing, Inc., petitioner in 00-809. Enron is supported by the Electric Power Supply Association (EPSA) and Electricity Consumers Research Council (ECRC), which essentially repeat Enron's arguments.

[2] The Federal Energy Regulatory Commission and its predecessor, the Federal Power Commission, will be referred to as "FERC."

"Attleboro gap" by empowering FERC to regulate wholesale electricity rates. Congress, however, preserved the states' regulation over retail matters by providing that "Federal regulation is to extend only to those matters which are not subject to regulation by the States" (emphasis added) (§ 201(a)).

Beginning in the late 1970's, new entrants into the generation market sought access to transmission lines in order to make bulk sales. Joint Appendix ("J.A.") 74-77, Enron Appendix ("App.") 152a-154a, Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities and Transmitting Utilities, Order No. 888 [1991-96 Reg. Preambles] F.E.R.C. Stats. & Regs. ¶ 31,036, 61 Fed. Reg. 21,540 (1996), ("FERC Order 888") at 31,643-44. Congress eventually responded in the Energy Policy Act of 1992 (EPAct) by giving FERC greater authority to require transmission owners to provide transmission service to power suppliers competing with utilities. 16 U.S.C. §§ 824j-824m.

While the statute clarified FERC's authority to order utilities to provide wholesale transmission service, it also "prohibited FERC from forcing utilities to engage in 'retail wheeling,' the transmission of power directly to a retail customer." House Comm. on Energy and Commerce, Energy Policy Act of 1992, P.L. 102-486, House Report No. 102-474(I) at 140 (1992), reprinted in 1992 U.S.C.C.A.N. 1953, 1963. Thus, it directed that "[n]othing in this subsection [§ 212(h)] shall affect any authority of any State or local government under state law concerning the transmission of electric energy directly to an ultimate consumer."

B. FERC's Decision

In the decision under review, FERC decided open access to transmission was necessary to advance competition in the wholesale power market. J.A. 48, Enron App. 131a, FERC Order 888 at 31,634. In addition to requiring wholesale open access, FERC preempted the states' jurisdiction of retail transmission when states "unbundle" the commodity from delivery (presumably to implement retail competition). It, however, recognized traditional state control over bundled retail transactions.

Thus, in Order 888, FERC adhered to established practice with respect to bundled service and acknowledged that Congress did not alter state regulation of all aspects of bundled retail service. J.A. 349-50, Enron App. 306a, FERC Order 888 at 31,781. On rehearing, FERC adhered to its position that it would not attempt to unbundle retail service. Enron App. 455a, Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Standard Costs by Transmitting Utilities, Order No. 888-A [Reg. Preambles] III F.E.R.C. Stats. & Regs. ¶ 31,048, 62 Fed. Reg. 12,274 (1997), ("FERC Order 888-A") at 30,225-226, citing FERC Order 888 at 31,781, J.A. 349-50.

C. The D.C. Circuit's Decision

On June 30, 2000, a Panel of the D.C. Circuit upheld FERC's decision not to preempt state regulation of bundled retail transmission service. Transmission Access Policy Study Group v. Federal Energy Regulatory Comm'n, 225 F.2d 667, 692-95 (D.C. Cir. 2000).

SUMMARY OF ARGUMENT

The State Petitioners' brief on the merits demonstrated that FERC Order 888 erred in assuming that the 1935 Congress: (1) failed to safeguard state regulation of the transmission portion of retail deliveries; (2) assigned FERC jurisdiction of unbundled retail transmissions in interstate commerce; and (3) provided that all retail transmissions on the interconnected grid would be in interstate commerce (State Petitioners at 10). Point I of Enron's brief combines (and expands) FERC's first two premises by contending that the 1935 Congress not only failed to deny FERC jurisdiction over matters regulated by the states, but removed jurisdiction of even bundled retail transmission jurisdiction from the states and gave it to FERC (Enron Brief as Petitioners in 00-809, hereafter "Enron" at 21-24). Enron's Point I -- that the 1935 Act preempted state regulation of retail transmission in interstate commerce -- is answered in Point I, below.

The second Point of Enron's brief claims that all retail transmissions on the interconnected grid are in interstate commerce (Enron at 27-33).[3] Point II below addresses Point II of Enron's brief.

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[3] This part of Enron's brief echoes FERC's third premise.

POINT I

THE 1935 CONGRESS DID NOT TRANSFER JURISDICTION OVER RETAIL TRANSMISSION SERVICE FROM THE STATES TO FERC

A. The Federal Power Act And Its Legislative History Rebuff Enron's Claim That The 1935 Congress Intended To Prevent State Regulation Of Retail Transmission

1. The FPA's Language Defeats Enron's Contention That FERC Has Had Jurisdiction Over All Retail Transmissions Since 1935

Enron's argument for FERC jurisdiction over transmissions in bundled retail rates ignores the FPA's goal of limiting federal regulation "to those matters which are not subject to regulation by the States." FPA § 201(a) [16 U.S.C. § 824(a)]. In giving FERC authority over matters the states could not regulate, Congress protected the states' jurisdiction over matters they could regulate, specifically retail transactions.

Neither Attleboro nor any other case law has even remotely suggested that state regulation of bundled retail transactions runs afoul of the Commerce Clause. To the contrary, Northern States Power Co. v. Federal Energy Regulatory Comm'n, 176 F.3d 1090, 1096 (8th Cir. 1999), rehearing denied, 1999 U.S. App. LEXIS 23493 (8th Cir. 1999), cert. denied sub nom., Enron Power Marketing v. Northern States Power Co., 528 U.S. 1182 (2000), held that FERC's "attempt to regulate the curtailment of electrical

transmission on native/retail consumers is unlawful, because it falls outside of the FPA's specific grant of authority to FERC." See General Motors Corporation v. Tracy, 519 U.S. 278, 294 (1997) [state can distinguish between bundled utility service and unbundled supply of gas in levying taxes].

As indicated in the State Petitioners' brief on the merits in Case 00-568 (at 27-28), Section 201(a) provides that "Federal regulation [is] . . . to extend only to those matters which are not subject to regulation by the States." Section 205 limits FERC's transmission authority by stating that it may set the rates for transmission "subject to the jurisdiction of the Commission. . . ." (emphasis added). Section 206(d) implicitly recognizes the states' jurisdiction over retail transmission by contrasting FERC's broad jurisdiction over transmission facilities with its lack of jurisdiction over retail service and calling on FERC to provide costs to states in order to facilitate state regulation of retail transmission service. See H.R. Rep. No. 74-1318, at 8 (bill takes no authority from States and authorizes FERC "to aid the State commissions in their efforts to ascertain and fix reasonable charges").[4]

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[4] Public Utility Holding Company Act of 1935, Hearings Before the Senate Committee on Interstate Commerce on S. 1725, 74th Cong. (1935) ("1935 Hearings on S. 1725") at 245, 247 (Memorandum of FERC Solicitor DeVane, "Analysis of Wheeler Bill, S. 1725, pp. 104 to 140") ["It cannot be too strongly emphasized that the ratemaking power conferred on the Commission by Sections 207 and 208 is limited to the field in which States have no constitutional authority. Under the provisions of this title, the power of the States to regulate retail distribution rates, even where the energy comes directly from another State is expressly preserved; wholesale rates alone are made the subject of the Commission's jurisdiction"].

Enron's position also flies in the face of EPAct. FPA § 212(h) [16 U.S.C. § 824k(h)] provides that "[n]othing in this subsection shall affect any authority of any State or local government under State law concerning the transmission of electric energy directly to an ultimate consumer."[5] If, as Enron claims, Congress meant to give FERC jurisdiction over all transmission, it would not have reserved to the states decisions on whether to allow transmissions directly to retail customers. Moreover, it would not have denied FERC authority to require unbundling of retail transactions.[6]

2. The FPA's Legislative History Demonstrates That Congress Preserved State Jurisdiction Over All Retail Deliveries

The legislative history of the 1935 Act evidences Congress' goal of filling the Attleboro gap, which prevented states from regulating wholesale electricity sales in interstate commerce while -- at the same time -- preserving state regulation of retail electric service, including retail transmissions (State Petitioners' Br. at 18-26). In claiming

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[5] Section 212(h)'s legislative history states that "[t]he bill's electricity provisions will promote additional competition in wholesale electricity power market in order to improve the efficiency of the electric utility industry and secure the lowest possible costs for consumers" (emphasis added). Energy Policy Act of 1992, P.L. 102-486, House Report No. 102-474(I) at 138 (1992), reprinted in 1992 U.S.C.C.A.N. 1953, 1961.

[6] Section 212(h) states "no order issued under this chapter shall be conditioned upon or require the transmission of electric energy: (1) directly to an ultimate consumer, or (2) to or for the benefit of an entity if such electric energy would be sold by such entity directly to an ultimate consumer . . ." [16 U.S.C. § 824k(h)].

that Congress intended to grant FERC plenary authority over retail transmissions in interstate commerce, Enron has selected four items from the legislative record, none of which support its theory (Enron at 23-25).

First, Enron cites the Senate Report on Section 201, which stated "[j]urisdiction is asserted ... over all interstate transmission lines whether or not there is a sale of the energy carried by those lines . . . ." (Enron at 23; quoting S. Rep. No. 74-621, at 48 (1935)). Immediately preceding the quoted language, however, the Senate Committee on Interstate Commerce stated that Section 201(b)

> leaves to the States the authority to fix local rates even in cases where the energy is brought in from another State. . . . The present bill carefully refrains from asserting Federal jurisdiction over these rates. The rate-making powers of the Commission are confined to those wholesale transactions which the Supreme Court held in Public Utilities Commission v. Attleboro Steam & Electric Co. (271 U.S. 83), to be beyond the reach of the States.

S. Rep. No. 74-621, at 48 (1935). Thus, Section 201(b) does not authorize FERC to regulate retail transmissions.

Second, Enron argues that Congress' failure to adopt an amendment to Section 201(b), offered by the National Association of Railroad and Utility Commissioners (NARUC), that would have limited federal jurisdiction "to the transmission and sale at wholesale of electric energy in interstate commerce," suggests that Congress intended FERC to regulate all transmission service (Enron at 23). Enron's

position is similar to that of a respondent-intervenor in Louisiana Public Service Comm'n v. Federal Communications Comm'n (FCC), 476 U.S. 355, 377 (1986), wherein GTE contended that Congress' rejection of anti-preemption language in the Communication Act's depreciation provision (47 U.S.C. § 220) demonstrated Congress' intent to allow FCC preemption of local depreciation charges. Just as GTE's argument ignored Congress' enactment of Section 152(b) of the Communications Act, which preserved state jurisdiction over intra-state telecommunication matters, Enron's contention ignores Congress' enactment of Section 201(a) of the FPA, which preserved pre-existing state regulation over retail matters.

In negotiating the 1935 FPA, as well as the 1934 Communications Act, the states were not wedded to particular language. Their sine qua non for the FPA was that the statute preserve pre-existing state jurisdiction. Thus, on the same day that NARUC offered its version of Section 201(b) it also successfully urged Congress to amend Section 201(a) to provide that "nothing contained in this title shall be construed to extend Federal regulation to that part of said business which is subject to regulation by the States."[7] See Public Utility Holding Cos. Hearings before House Committee on Interstate and Foreign Commerce on H.R. 5423 ("1935 Hearings on H.R. 5423"), 74th Congress (1935) (statement of

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[7] Section 201(a), as enacted, allows "such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States." 16 U.S.C. § 824(a). Mr. Benton stated that such language should "be incorporated as a clear declaration by Congress of its intent to grant the power to the Federal body to regulate that which is beyond the jurisdiction of the local commission" (emphasis added). 1935 Hearings on H.R. 5423 at 1677.

John E. Benton, General Solicitor of NARUC), at 1660. Because the states regulated retail transmission in 1935, preserving pre-existing state regulation would safeguard state regulation of retail transmissions. See Benton, 1935 Hearings on S. 1725 at 767-68, 1935 Hearings on H.R. 5423 at 1657; DeVane, 1935 Hearings on H.R. 5423 at 498 ["The theory upon which the bill is drawn is that the consumer's rate is left to regulation by state commissions."]

Congress accepted § 201(a) and thereby preserved pre-existing state regulation "even in those cases where the energy is brought in from another State" (H.R. Rep. No. 74-1318 at 27 (1935)). Although FERC opposed NARUC's original version of § 201(b) limiting federal jurisdiction to those utilities that transacted the majority of their business in interstate commerce (because it could have impeded FERC's ability to facilitate interconnections) (DeVane, 1935 Hearings on H.R. 5423 at 2144-2149), it supported § 201(a), acknowledging that Section 201(a) limited FERC's rate jurisdiction to wholesale transactions in interstate commerce (DeVane, 1935 Hearings on H.R. 5423 at 497-498, 518) and noted that it did not wish to regulate retail matters.[8] The states, in turn, supported the FPA because Section 201(a), among other things, safeguarded their jurisdiction over all elements of retail service. See Jersey Central Power & Light Co. v. Federal Power Comm'n, 319 U.S. 61, 74 (1943) [§ 201(a) preserves state regulation over "generation, transmission and sales" to retail customers] (emphasis added).

Enron's third selection of legislative history is a statement by Mr. Arkwright, the then-President of Georgia

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[8] DeVane, 1935 Hearings on H.R. 5423 at 2143, 2144, 2146, 2154.

Power Company. Mr. Arkwright stated that "[w]hether it be wholesale or retail, as I understand it, the transmission of the current from one State to another is interstate commerce" (Enron 23-24). 1935 Hearings on H.R. 5423 (statement of John Preston Arkwright), at 661. He then went on, however, to offer his opinion that:

> electric current distributed is subject exclusively to the jurisdiction of the State for regulation, no matter where the current came from, whether it had been transmitted across State lines or not.

Id. at 666.

Last, Enron argues that the House and Senate committee reports confirm that FERC's jurisdiction over transmission in interstate commerce should include transmission for bundled retail transactions (Enron at 25). The committee reports confirm the opposite -- that Congress understood that the states would have jurisdiction over retail transmissions.

The House Report states that "the authority of States to fix local rates is not disturbed even in those cases where the energy is brought in from another State." H.R. Rep. No. 74-1318 at 27 (1935). If the House Committee on Interstate and Foreign Commerce had intended to grant FERC jurisdiction over retail transmission, it would not have declared, in the face of the states' then long-standing role in deciding retail electric matters, that "[t]he bill takes no authority from State commissions and contains provisions authorizing the Federal Commission to aid the State commissions in their efforts to ascertain and fix reasonable charges." Id. at 8. Indeed, the Committee mused that "[p]robably, no bill in recent years has

so recognized the responsibilities of State regulatory commissions as does title II of this bill." Id. at 8.

Likewise, the Senate Committee on Interstate Commerce reported that the FPA was designed to fill the gap in the regulation of interstate wholesale sales created by the Attleboro case (S. Rep. No. 74-621, at 17) and to provide FERC jurisdiction over "interstate transmission where there is no sale." Id. at 19. Rather than asserting jurisdiction over retail transmission, the Senate report eschews "every encroachment upon the authority of the States. The revised bill would impose regulation only over those matters which cannot effectively be controlled by the States." Id. at 18.

3. All Relevant FPA Case Law Refutes Enron's Position

Enron and its supporters (ECRC and EPSA) essentially claim that FERC has misread the FPA for more than 65 years. Case law under the FPA indicates otherwise. Federal Power Comm'n v. Southern California Edison Co., 376 U.S. 205, 212-15 (1964) [There is a "bright line" between state power over retail transactions and federal power over wholesale transactions].[9]

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[9] Enron basically reiterates the contentions rejected by the Circuit Court of Appeals in Northern States Power, 176 F.3d at 1090. Specifically, Enron again claims that Federal Power Comm'n v. Louisiana Power & Light, 406 U.S. 621 (1972) supports FERC jurisdiction over bundled retail transmission (Enron at 8, 17, 22-24) and that FERC must regulate the retail transmission element of bundled retail service in order to correct alleged discrimination against wholesale competitors (Enron, 39-43) (Compare Enron Reply Brief In Support of Petition for Certiorari, at 6-7 in Enron Power Marketing Inc. v. Northern States Power Co., Supreme

This Court has emphasized that the purpose of the FPA was to "adopt the test developed in the Attleboro line, which "denied state power to regulate a sale 'at wholesale to local distributing companies' and allowed state regulation of a sale 'at local retail rates to ultimate consumers. (emphasis added)'"; [citation omitted]. FPC v. Southern Cal. Edison Co., 376 U.S. at 214. United States v. Public Utilities Comm'n of California, 345 U.S. 295, 308 (1953) ["Congress interpreted [Attleboro] as prohibiting state control of wholesale rates in interstate commerce for resale, and so armed the Federal Power Commission with precisely that power"].

Enron argues (Enron at 8, n. 8) that the wholesale/retail demarcation of FPC v. Southern California Edison Co. applies only to "sales."[10] FPC v. Southern California Edison and Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n, 461 U.S. 375, 380 (1983) held, however, that the wholesale/retail line is a mechanistic dividing line between state and federal jurisdiction.[11]

Court No. 99-916).

[10] By "sales," Enron apparently refers to the provision of energy. A retail transaction involves the provision and sale of the commodity, transmission, distribution, metering and billing service.

[11] FPC v. Southern California Edison Co., 376 U.S. at 215-16 ["Congress meant to draw a bright line easily ascertained between state and federal jurisdiction, making unnecessary such case-by-case analysis"]. Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n, 461 U.S. 375, 380 (1983) ["Congress, partly to avoid 'drawing the precise line between federal and state power by the litigation of particular cases' ... had adopted the 'mechanical' line established in Kansas Gas and Attleboro as the statutory line

Further, Enron argues (Enron at 26-27) that the FERC retail transmission price should be an element of the retail rate, citing the holding of Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953, 966 (1986), that a state regulator should recognize a FERC-approved wholesale rate. Nantahala recognized FERC's "exclusive jurisdiction over the rates to be charged Nantahala's interstate wholesale customers" (emphasis added). 476 U.S. at 966. It did not, however, permit FERC to set a bundled retail rate. Rather, Nantahala held that states must recognize FERC wholesale rates, and FERC allocations of wholesale power as costs, in setting retail rates. 476 U.S. at 971.[12]

B. Enron's Reliance On NGA Case Law Is Misplaced

Enron and EPSA reference (Enron at 17, 22, 32; EPSA at 6) case law under the Natural Gas Act (NGA) for the proposition that FERC, not the states, must regulate the transmission component of a bundled retail transaction. Enron claims that the Court has followed an "established practice of citing interchangeably decisions interpreting the

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dividing federal and state jurisdiction"]. If such a mechanical line is to have its intended benefits of simplifying jurisdictional controversies, it must apply to the statute as a whole.

[12] EPSA argues (EPSA Brief "EPSA" at 12-13) that FPC v. Conway Corp., 426 U.S. 271 (1976), supports FERC power over retail services insofar as that case concluded FERC had jurisdiction to address a "price squeeze" between retail and wholesale rates. Inasmuch as FPC v. Conway Corp. held FERC could not adjust a retail rate, it supports the States' position in this case. 426 U.S. at 276-77. FERC could consider the difference between wholesale and retail rates, but it could only do so in setting the wholesale rate. 426 U.S. at 280.

pertinent sections of the two statutes" (Enron at 22, citing Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571, 577, n. 7 (1981)), but that practice is apparently followed, however, only when the "relevant provisions of the two statutes 'are in all material respects substantially identical (emphasis added).'" 453 U.S. at 577, n. 7, citing Federal Power Comm'n v. Sierra Power Co., 350 U.S. 348, 353 (1956). The Natural Gas Act contains no "relevant" provision similar to FPA Sections 201(a) or 212(h).

Enron chiefly relies on Federal Power Comm'n v. Louisiana Power & Light Co., 406 U.S. 621 (1972), which held that FERC could curtail interstate transportation of natural gas to industrial customers, although the transportation was occurring in association with non-jurisdictional direct sales of natural gas. 406 U.S. at 640-41. The case is not supportive of Enron's position for several reasons.

First, it did not concern NGA § 1(c), 15 U.S.C. § 717(c), which provides that where a gas buyer and seller are in the same state, FERC does not have jurisdiction over retail deliveries. ["The provisions of this chapter shall not apply to any person engaged in or legally authorized to engage in the transportation in interstate commerce or the sale in interstate commerce for resale, of natural gas received by such person from another person within or at the boundary of a State if all the natural gas so received is ultimately consumed within such State, or to any facilities used by such person for such transportation or sale, provided that the rates and services of such person or facilities be subject to regulation by a State commission"].[13] Second, Federal Power

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[13] We anticipate Enron will argue that the existence of NGA § 1(c) supports its position because such a provision was not included in

Comm'n v. Louisiana Power & Light did not concern NGA § 7f(2), 15 U.S.C. § 717f(2), which denies FERC jurisdiction over service across state lines to retail consumers if the transportation is in the utility's service territory.[14] ["[T]ransportation to ultimate customers in such service area by the holder of such service area determination, even if across state lines, shall be subject to the exclusive jurisdiction of the State commission in the State in which the gas is consumed"]. Third, as indicated, the NGA does not contain a corollary to either FPA § 201(a) or § 212(h), which-again-deny FERC jurisdiction over retail transmissions.

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the Federal Power Act. However, such an argument would ignore the fact that FERC had repeatedly argued that the addition of any amendment like NGA § 1(c) to the Federal Power Act was unnecessary because the Federal Power Act adequately protected state authority over retail rates and local services. Amendments to Federal Power Act, Hearings on H.R. 2972 before the House Committee on Interstate and Foreign Commerce, 80th Cong. (1947) at 336 (statement of FERC Chairman Smith) 527, 548, 574-75 (statement of FERC Assistant General Counsel Wahrenbrock). Federal Power Act Amendments of 1967, Hearings on H.R. 5348, H.R. 5637, H.R. 7799, H.R. 8426, H.R. 8919, H.R. 9174 before the Subcommittee on Communications and Power of the House Committee on Interstate and Foreign Commerce, 90th Cong. (1967) at 123-125 (statement of FERC Chairman White).

[14] Electric utilities sell electricity to retail customers in their service territories.

C. Enron's Contentions That FERC Has Violated Section 206 By Not Preempting State Regulation Of Retail Transmission Service And Thereby Created A Regulatory Gap Are Misplaced

Enron and ECRC allege that Section 206 requires FERC to regulate retail transmission service because the States are unable to prevent vertically integrated utilities from providing retail transmission service in a manner that prejudices wholesale competitors (Enron at 31-32, ECRC Brief ("ECRC") at 12-13). Its position misconstrues Congress' intent in enacting Section 206 and ignores the states' demonstrated ability to prevent discriminatory utility behavior.

1. Section 206 Was Not Intended To Authorize, Much Less Require, FERC Preemption Of Retail Transmission Service

Section 206(a) allows FERC, on its own motion, to examine whether utility rates "subject to the jurisdiction of the commission" are discriminatory and, if so, to rectify such discrimination. Subdivision (d) of Section 206 recognizes state authority to set transmission rates and empowers FERC to assist state ratemaking by providing states, upon request, "the cost of the . . . transmission of electric energy by means of facilities under the jurisdiction of the Commission . . . ." Section 206, therefore, authorizes FERC to correct discriminatory wholesale rates and to assist the states in setting retail rates.

2. Enron's Claims Of A Regulatory Gap Are Baseless

Enron, ECRC and EPSA contend that FERC Order 888 allows a vertically integrated utility to discriminate against wholesale competitors by reserving large portions of the interstate grid for bundled retail transactions and leaving wholesale competitors with insufficient capacity (Enron at 41-43, ECRC at 19-20, EPSA at 6-10). Order 888, however, limits the ability of a utility to reserve transmission capacity for native load to levels needed to accommodate reasonable growth. J.A. 291, Enron App. 267a, FERC Order 888 at 31,745. If a utility unreasonably forecasts growth, and thereby foregoes revenue from wholesale customers, regulators may impute the foregone revenue to the utility for retail ratemaking purposes, leaving utility management answerable to shareholders. See Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953, 972 (1986) ["Without deciding this issue, we may assume that a particular quantity of power provided by a utility from a particular source could be deemed unreasonably excessive [by a state commission] if lower cost power is available elsewhere . . ."]; Rochester Gas & Electric Corporation v. Public Service Comm'n of the State of New York, 754 F.2d 99 (2d Cir. 1985) [upholding NYPSC imputation of incidental revenues from wholesale sales].

Enron's and EPSA's allegation that state commissions are unable to eliminate undue discrimination (Enron at 44, EPSA at 10) is also incorrect.[15] State regulators are

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[15] Arkansas Electric Cooperative Corp. v. Arkansas Pub. Serv. Comm'n, 461 U.S. 375, 377, 384 (1983) does not support Enron's argument that the FPA leaves a regulatory gap (Enron at 32-33).

authorized to (1) assure that retail transmission rates are "just and reasonable" (e.g., New York Public Service Law [NYPSL] § 65(1); (2) require utilities to provide services in a non-discriminatory manner (NYPSL § 65(3)); see also Idaho Code Section 61-315; (3) prescribe corrective behavior if a utility acts in "anywise in violation of any provision of law" (NYPSL § 66(6)); and (4) "order such improvement in the. . . transmission of electricity or in the methods employed by such person or corporation, as will in its judgment be adequate, just and reasonable" (NYPSL § 72).[16] Indeed, state regulatory agencies normally have "general supervision of all . . . electric corporations" and "all electric plants" and "all powers necessary or proper to enable it to carry out the purposes of" the Public Service Law (e.g., NYPSL §§ 66(1); 4(1)).

State law prohibits utilities from granting "an undue preference or advantage to any person, corporation or locality, or to any particular description of service (emphasis

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In that case, the Court relied on the fact that retail utilities receive out of state power, "and the national fabric does not seem to have been seriously disturbed by leaving regulation of retail utility rates largely to the states." 461 U.S. at 395. Here, of course, Enron is trying to limit state regulation of the very out-of-state transmission of energy on which the Court relied as a basis for its decision in Arkansas Electric Corp. Enron argues that Arkansas Electric Coop. Corp. shows Congress did not intend to leave the electric industry unregulated (Enron at 32-33, quoting 46 U.S. at 384). The Court relied upon that principle to reject claims like Enron's that states were preempted.

[16] The New York Public Service Law is illustrative of state power to address discrimination. Other states have very similar grants of jurisdiction.

added)"; (e.g., NYPSL § 65(3); New York General Business Law § 340 et seq. (precluding monopolies)). Utilities, therefore, may not grant themselves preferences (NYPSL § 2(13)). See Matter of Energy Ass'n of New York State v. Public Service Commission of the State of New York, 169 Misc. 2d 924, 932-36, 653 N.Y.S. 2d 502, 510-512 (Albany County 1996). See also, Case 94-C-0095, Issues Related to the Continuing Provision of Universal Service and to Develop a Regulatory Framework for the Transition to Competition in the Local Exchange Market, Opinion No. 96-13, Opinion and Order Adopting Regulatory Framework, New York Public Service Commission, 1996 N.Y. PUC LEXIS 270 [A 39]; 171 P.U.R. 4th 30, 43 (issued May 22, 1996) [discussing imputation guidelines for comparing retail and wholesale prices]; Case 89-C-099, Applicability of Common Carrier Concept to Modern Telecommunications; Opinion No. 90-9, Opinion and Order Adopting Regulations Concerning Common Carriage, New York Public Service Commission, 1990 N.Y. PUC LEXIS 4; 110 P.U.R. 4th 107 (issued February 20, 1990).

Additional state commission tools for avoiding anti-competitive utility behavior include conditioning discretionary rates on non-preferential use of utilities' transmission networks and acting on complaints of customers seeking the delivery of competitors' electricity. New York ex rel. Woodhaven Gas Light Co. v. Public Serv. Comm'n, 269 U.S. 244, 248 (1925) [upholding the state's power to require utilities to extend services for legitimate public purposes]; California v. ARC America Corp., 490 U.S. 93, 103 (1989) [rejecting claims that state antitrust laws are preempted by federal law because "[i]t is one thing to consider Congressional policies . . . in defining what sort of recovery federal antitrust law authorizes; it is something altogether different, and in our view inappropriate, to consider them as

defining what federal law allows states to do under their own antitrust law"]. See Younger v. Jensen, 26 Cal. 3d 397, 605 P.2d 813 (1980) [state antitrust investigation against regulated entities].

Rather than simply reacting to claims of discrimination, state commissions have also acted to discourage discriminatory use of retail transmission service. New York State, for example, has removed utility incentives to use the delivery system in a discriminatory manner by inducing the sale of nearly all utility-owned power plants.[17]

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[17] Cases 96-E-0900, 94-E-0098, 94-E-0099, 96-E-0891, 96-E-0897, 96-E-0909 - Orange & Rockland Utilities, Inc., Niagara Mohawk Power Corporation, New York State Electric & Gas Corporation, Consolidated Edison Company of New York Inc., Central Hudson Gas & Electric Corporation, - Plans for Electric Rate Restructuring, Statement of Policy Regarding Vertical Market Power [encouraging divestiture], 1988 N.Y. PUC LEXIS 432; 187 P.U.R. 4th 223 (July 17, 1998). See also New York Orders approving divestiture plans. Case 96-E-0909, Central Hudson Gas & Electric Corporation - Plans for Electric Rates and Restructuring - Order Authorizing the Process for the Auctioning of Generation Plan and Modifying Prior Orders, 2000 N.Y. PUC LEXIS 93 (issued February 23, 2000); Case 96-E-0897, Consolidated Edison Company of New York. - Plans for Electric Rates and Restructuring, Order Authorizing the Process for the Auctioning of Generation Plant, 1998 N.Y. PUC LEXIS 414, 188 P.U.R. 4th 149; Case 96-E-0891, New York State Electric & Gas Corporation - Plans for Electric Rates and Restructuring, Order Authorizing the Process for the Auctioning of Generation Plant (1998 N.Y. PUC LEXIS 192 (issued April 24, 1998); Cases 94-E-0098 and 94-E-0099, Niagara Mohawk Power Corporation - PowerChoice Rate and Restructuring Plan, Order Authorizing Process for the Auctioning of Generating Facilities, 1998 N.Y. PUC LEXIS 259 (issued May 6, 1998); Case 96-E-0900, Orange and Rockland

With states serving as regulatory laboratories, retail competition is gradually taking root. See Federal Energy Regulatory Comm'n v. Mississippi, 456 U.S. 742, 788 (1982) ["Courts and commentators frequently have recognized that the 50 States serve as laboratories for the development of new social, economic and political ideas" (O'Connor, J. dissenting). See also, Connecticut Light & Power Co. v. Federal Power Comm'n, 324 U.S. 515, 529 (1945) [Congress thought it "wise to keep the hand of state regulatory bodies in this business, for the 'insulated chambers of the states' are still laboratories where many lessons in regulation may be learned by trial and error on a small scale without involving a whole national industry in every experiment"].[18] If restructuring programs are to create a fair playing field for utility competitors while protecting energy consumers from potential rate shock, regulators must assess customer needs, the capabilities of transmission and distribution infrastructures, the "margins" available in unbundled retail rates and potential competitive interests in providing unbundled services. State regulators are closest to these questions and they are prepared to implement strategies to

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Utilities, Inc. - Plans for Electric Rates and Restructuring, Order Authorizing the Process for the Auctioning of Generation Plant and Rejecting Joint Agreement, 1998 N.Y. PUC LEXIS 259 (issued April 16, 1998); 1998 N.Y. PUC LEXIS 374.

[18] See, e.g., Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act to Provide In-Region, InterLATA Service in the State of New York (CC Docket No. 99-295), Memorandum Opinion and Order, FCC 99-404, ¶ 6, n. 5 (December 22, 1999) [FCC decision praising state innovations that opened the door to competition].

open markets in a meaningful, effective manner.[19] Their efforts to do so, however, have been impeded by "one-size-fits-all" regulation.

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[19] Case 98-M-0667, Electronic Data Interchange,Opinion No. 00-05, Opinion and Order on Implementation of Electronic Data Interexchange, New York Public Service Commission, 2000 N.Y. PUC LEXIS 411, 200 P.U.R. 4th 329 (April 12, 2000); Case 99-M-0631, Customer Billing Arrangements Alternative Billing Arrangements, New York Public Service Commission, Order Providing for Customer Choice of Billing Entity, 2000 N.Y. PUC LEXIS 283, 200 P.U.R. 4th 149 (issued March 22, 2000); Case 98-M-1343, Retail Access Business Rules, Opinion No. 99-3, Opinion and Order Concerning Uniform Business Practices, New York Public Service Commission, 1999 N.Y. PUC LEXIS 28, 190 P.U.R. 4th 369 (issued February 16, 1999), rehearing granted in part, 1999 N.Y. PUC LEXIS 95, (issued April 15, 1999); Case 94-E-0952, Competitive Opportunities Regarding Electric Service, New York Public Service Commission, Order Providing for Competitive Metering, 1999 N.Y. PUC LEXIS 280, 194 P.U.R. 4th 129 (issued June 16, 1999); Case 94-E-0952, Competitive Opportunities Regarding Electric Service, Opinion No. 97-13, Opinion and Order Establishing Regulatory Policies for Competitive Metering, New York Public Service Commission, 1997 N.Y. PUC LEXIS 450, 181 P.U.R. 4th 324 (issued August 1, 1997); Cases 94-E-0952 et al., Competitive Opportunities Regarding Electric Service, Opinion No. 96-12, Opinion and Order Regarding Competitive Opportunities for Electric Service, New York Public Service Commission, 1996 N.Y. PUC LEXIS 330, 168 P.U.R. 4th 515 (issued May 20, 1996).

POINT II

ENRON'S CLAIM THAT ALL TRANSMISSIONS ON THE INTERCONNECTED GRID ARE IN INTERSTATE COMMERCE IS IRRELEVANT AND, IN ANY EVENT, INCORRECT

The second principal argument of Enron's brief on the merits is that all retail transmissions on the interconnected grid are in interstate commerce. Enron's contention is irrelevant because, as indicated above, Congress assigned the states jurisdiction of all retail transactions, including retail transmissions in interstate commerce.[20] It is also, however, incorrect.[21]

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[20] Whether a transmission is interstate is, as discussed below, governed by § 201(c), which provides that energy is transmitted interstate if it is carried from one state and consumed in another state. The definition is relevant not for determining which services FERC may regulate (FERC regulates wholesale transmissions; the states regulate retail transmissions), but for deciding which companies fall within FERC's general jurisdiction (e.g., § 203 [review and security purchases], § 204 [review and security sales]). Owners of facilities that transmit energy in interstate commerce, irrespective of whether the transmissions are retail or wholesale, are "public utilities" under § 201(e), which governs the applicability of such sections as 203 and 204 and, are therefore subject to FERC's jurisdiction. Jersey Central Power & Light v. FPC, 319 U.S. 61, 73-74 (1943) ["although a company may be a public utility under subsection (e), all of its transactions do not thereby fall under the regulatory power of the Commission. . . . [201(a)'s] limitation is directed at generation, transmission and sale"].

[21] The State Petitioners' initial brief on the merits addressed this issue (Point II.B.C., pp. 36-46); this brief will respond to the Enron

A. The Interrelationship Of Transactions On The Grid Does Not Render Retail Transmissions Interstate

In contending that all retail transmissions are in interstate commerce, Enron assumes that all transactions affect the entire grid (Enron at 6, 7). Its assumption is arguably accurate, from a theoretical standpoint, but misleading to the extent Enron uses it to suggest that all, or most, transmissions cross state lines.

If a person on a boat in the Atlantic Ocean tosses a pebble into the water, the pebble will sink and a ripple of water will appear, but there will be no other consequences. In theory, however, consistent with Enron's argument on electricity flows, the pebble's entry into the water will cause water molecules, and energy, to ripple across the entire ocean. The theory is technically correct, but inconsequential to the person in the boat because, among other things, the water molecules surrounding the boat will not travel any measurable distance.

When a customer in New York City turns on a 60 watt lightbulb, the energy required to light the bulb is supplied by increases in output of nearby New York City generators. Electric Power Research Institute (EPRI), A Primer on Electric Power Flow for Economists and Utility Planners (1995), at 2-8, 3-2; J.A. 822-823; 829-830. R. Sarikas, Introduction to Electrical Theory and Power Transmission (1995), at 70. The reaction of distant electrons in the grid is immeasurable because electrical impedance (resistance), which directs the closest power on the grid to a load, also dictates that a load change at one point on the grid has no

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arguments that have not been answered.

appreciable impact on other areas of the grid. EPRI, supra, at 2-8, 3-2; J.A. 822-823; 829-830; Sarikas, supra, at 70.

Thus, contrary to Enron's claims (Enron at 6), all generation on the interconnected grid does not serve all customers on the grid. See B.M. Weedy, B.J. Cory, Electric Power Systems (1998) at 175 ["When large interconnected systems are linked electrically to others by means of tie-lines the power transfers between them are usually decided by mutual agreement and the power is controlled by regulators (devices that control the flow of power").]

B. Interconnections Since 1935 Are Not Relevant To The States' Jurisdiction Over Retail Transmissions

Enron alleges that although 47 states are interconnected today, only a "fraction of the nation's electric systems were interconnected" in 1935 (Enron at 7). "While in 1928, 10.7 percent of the power generated in the United States was transmitted across State lines, in 1933 more than 17.8 percent of all the energy generated in the United States flowed in interstate commerce — an amount greater than the entire amount generated in the country in 1913." 1935 Hearings on S. 1725 at 797. "Ryan-DeVane Memorandum." See also S.R. No. 74-621, at 17 (1935). Congress, therefore, understood the trend toward increased interconnections when it preserved the states pre-existing regulation of retail transmission. Inasmuch as increased interconnections since 1935 do not alter the FPA's language, they are not relevant to whether FERC may (or must) set retail transmission rates. See Arkansas Electric Coop. Corp. v. Arkansas Public Service Comm'n, 461 U.S. 375, 384, n. 8 (1983) ["Congress sought to freeze its perception of Attleboro into law . . ."].

C. The 1935 Report Further Supports State Jurisdiction Over Retail Transmission Service

Enron (Enron at 30) alleges that a report to the 1935 Congress states that interconnection facilities were subject to FERC jurisdiction. Again, facilities may be subject to FERC's jurisdiction, but the retail service they provide is subject to state regulation. The 1935 Hearings noted that Public Utilities Comm'n of Rhode Island v. Attleboro Steam & Electric Co., 273 U.S. 83 (1927) distinguished a wholesale sale of energy across state borders, which could not be regulated by a state, from a transaction "by which gas or electric energy was transmitted across State boundaries but directly to consumers. In such a case it was held that the State in which consumption took place might regulate the rates." 1935 Hearings on H.R. 5423 at 96 (discussing Pennsylvania Gas Co. v. Public Service Comm'n, 252 U.S. 23 (1920)). Further, to the extent the cited report states that "the theory of State regulation may become obsolete" as a result of interconnections, it refers to a theory that the states may regulate the electric industry alone, without federal assistance. 1935 Hearings on H.R. 5423 at 77. ["[O]nce the industry begins to transcend State boundaries either by physical interconnections or by subtle business and financial affiliations the theory of State regulation may become obsolete. . . . attempts by the individual States to extend their laws to cover the holding-company system are met with more serious jurisdictional objections."]

D. The Case Law Cited By Enron Does Not Support Its Position

Enron argues that Federal Power Comm'n v. Florida Power & Light Co., 404 U.S. 453, 463 (1972) stands for the proposition that all transmissions on interstate grids are

FERC-jurisdictional.[22] Florida Power & Light neither accepted nor rejected the theory that all generators on an interconnected grid provide a pool of interstate energy that services all load requirements throughout the grid (Enron 28, 30). The Court found it unnecessary to approve or disapprove an "analysis based upon unity of electromagnetic response" (404 U.S. at 461-62).

Enron also relies (Enron at 31) on a statement from Northern States Power Co. v. Federal Energy Regulatory Comm'n, 30 F.3d 177, 179 (D.C. Cir. 1994), that "[t]here is no way to determine what path electricity actually takes between two points or indeed whether the electricity at the point of delivery was ever at the point of origin." Congress addressed the possibility that electricity generated in one state and used in that state might take a path outside state boundaries. It provided in FPA § 201(c) that electricity would only be in interstate commerce if it was produced in one state and consumed in another state.

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[22] Enron relies upon Justice Douglas' dissent from the supposed result of Florida Power & Light that "the commingled method will now mean that every privately owned interconnected facility in the United States (except for those isolated in Texas) is within the [FERC's] jurisdiction." 404 U.S. at 471 (Douglas, J. dissenting). Justice Douglas, however, also noted "[a]ll that is involved here is an effort to make [Florida Power & Light] follow [FERC's] Uniform System of Accounts." 404 U.S. at 472-73 (Douglas, J. dissenting).

CONCLUSION

For the reasons indicated above, Enron's challenge to FERC's Orders 888 and 888-A should be rejected.

Respectfully submitted,

Lawrence G. Malone*
General Counsel
Jonathan D. Feinberg
Carl F. Patka
Diane T. Dean
Assistant Counsel
NYS Public Service Commission
Three Empire State Plaza
Albany, New York 12223-1350
(518) 474-2510

**Counsel of Record*

Dated: May 2001
Albany, NY

James Bradford Ramsay
General Counsel
Sharla Barklind
Assistant General Counsel
National Association of Regulatory
Utility Commissioners
1101 Vermont Avenue, Suite 200
Washington, D.C. 20005
(202) 898-2208

Catherine D. Bedell
General Counsel
Richard Bellak
Associate General Counsel
Florida Public Service
Commission
2540 Shumard Oak Boulevard
Capital Circle Office Center
Tallahassee, FL 32399-0850
(850) 413-6092

Alan G. Lance
Attorney General
Donald L. Howell, II
Deputy Attorney General
Idaho Public Utilities
Commission
472 W. Washington Street
P.O. Box 83720
Boise, ID 83720-0074
(208) 334-0312

John J. Farmer, Jr.
Attorney General
State of New Jersey
Helene S. Wallenstein
Sr. Deputy Attorney General
Attorney for New Jersey Board
of Public Utilities
124 Halsey Street, 5th Floor
P.O. Box 45029
Newark, New Jersey 07101
(973) 648-4846

Jo Anne Sanford
North Carolina Utilities Comm'n
Robert P. Gruber
Public Staff - North Carolina
Utilities Comm'n
Gisele L. Rankin
Staff Attorney
4326 Mail Service Center
Raleigh, NC 27699-4326
(919) 733-2435

William H. Chambliss
General Counsel
C. Meade Browder, Jr.
Associate General Counsel
Virginia State Corporation Comm'n
Office of General Counsel
P.O. Box 1197
Richmond, VA 23218
(804) 371-9671

Christine O. Gregoire
Attorney General
William Berggren Collins
Sr. Assistant Attorney General
Robert D. Cedarbaum
Senior Counsel
(for the Washington Utilities and
Transportation Commission)
P.O. Box 40128
Olympia, WA 98504-0128
(360) 664-1188

Harvey L. Reiter
(for the Vermont Department of Public Service)
Morrison & Hecker.
1150 18th Street, N.W.
Suite 800
Washington, D.C. 20036
(202) 785-9100

Harry Ivey
(for the Wyoming Public Service Commission)
Attorney General's Office
State of Wyoming
123 Capitol
Cheyenne, WY 82002
(307) 777-7824

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Nos. 00-568 and 00-809

In the Supreme Court of the United States

STATE OF NEW YORK, ET AL., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ENRON POWER MARKETING, INC., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ON WRITS OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

KEVIN P. MADDEN
General Counsel
CYNTHIA A. MARLETTE
Deputy General Counsel
SUSAN J. COURT
Associate Solicitor
TIMM L. ABENDROTH
DAVID H. COFFMAN
Attorneys
Federal Energy Regulatory Commission
Washington, D.C. 20426

BARBARA D. UNDERWOOD
Acting Solicitor General
Counsel of Record
EDWIN S. KNEEDLER
Deputy Solicitor General
AUSTIN C. SCHLICK
Assistant to the Solicitor General
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

QUESTIONS PRESENTED

In its Order No. 888, the Federal Energy Regulatory Commission found that public utilities subject to its jurisdiction under the Federal Power Act (FPA or Act), 16 U.S.C. 791a *et seq.*, had discriminated unlawfully in providing access to their facilities for transmitting electric power, and had the ability and incentive to continue to do so. As a remedy, Order No. 888 requires those utilities to provide nondiscriminatory access to their transmission systems, thereby facilitating competition in the market for electric energy.

1. In No. 00-568, the question presented is whether the court of appeals correctly determined that Section 201 of the FPA, 16 U.S.C. 824, authorizes the Commission to exercise jurisdiction over the service of transmitting in interstate commerce electric energy that is sold at retail, where the transmission service is "unbundled" from the State-regulated retail sale of energy and the retail customer has the ability to choose a preferred power supplier.

2. In No. 00-809, the question presented is whether the court of appeals properly deferred to the Commission's determination that it lacks jurisdiction over retail transmission service that is sold together with electric energy in a single "bundled" transaction between a public utility and its retail customer, where the retail customer cannot choose a preferred power supplier.

PARTIES TO THE PROCEEDING

The petitioners and intervenors in the court of appeals are set forth in Volume II of the Petition Appendix in No. 00-568 at R1-R7 and in Volume II of the Petition Appendix in No. 00-809 at 683a-688a.

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OPINIONS BELOW

The opinion of the court of appeals (1 Pet. App. 3a-121a)[1] is reported at 225 F.3d 667. The relevant orders of the Federal Energy Regulatory Commission are reported as follows: Order No. 888, 61 Fed. Reg. 21,540 (1996) (excerpted at 1 J.A. 42-430), and Order No. 888-A, 62 Fed. Reg. 12,274 (1997) (excerpted at 2 J.A. 517-791).

[1] Unless otherwise indicated, all references to "Pet. App." are to the petition appendix in No. 00-809. We refer to the state petitioners in No. 00-568, collectively, as "New York."

JURISDICTION

The judgment of the court of appeals (1 Pet. App. 1a-2a) was entered on June 30, 2000. Petitions for rehearing were denied on August 22, 2000 (1 Pet. App. 123a-124a). The petition for certiorari in No. 00-568 was filed on October 12, 2000. The petition in No. 00-809 was filed on November 20, 2000. The petitions were granted on February 26, 2001. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

Relevant provisions of Part II of the Federal Power Act, 16 U.S.C. 824-824m, are set out at 2 Pet. App. 652a-681a.

STATEMENT

This case involves one of the critical jurisdictional underpinnings of the Federal Energy Regulatory Commission's program for promoting competition in the electric power industry. Commission Order No. 888 requires public utilities to "unbundle" their generation and wholesale sales of electric power from their wholesale transmission of electric power, and to provide other power suppliers nondiscriminatory access to their transmission systems. Unbundling and "open access" to transmission systems enable energy producers to deliver electric power across the Nation's interstate power grids, and prevent utilities from using their control over essential transmission systems to undermine the increasingly competitive market for electric energy.

When crafting Order No. 888, the Commission exercised its jurisdiction in accordance with Part II of the Federal Power Act (FPA or Act), 16 U.S.C. 824-824m. Broadly speaking, Section 201 of the FPA gives the Commission jurisdiction over the transmission and wholesale sale of electric energy in interstate commerce, while leaving regulation of local distribution and retail sales of electric energy to the States. 16 U.S.C. 824. The Commission interpreted Section 201 as preserving the States' historical jurisdiction over

traditional monopoly arrangements—under which retail customers buy electric energy, transmission service, and local distribution service from a single, regulated supplier for a single charge. Accordingly, under Order No. 888, States may continue to regulate the entirety of those bundled retail sales, just as before. But if a public utility voluntarily permits retail customers to purchase power from competing suppliers, or if a State chooses to require such competition, then the Commission's new open-access rule would extend to the utility's separately offered service of transmitting electric energy in interstate commerce in connection with the unbundled retail sale of energy. Even in that case, however, the State would continue to have exclusive jurisdiction over the retail sale of energy and over local distribution of the energy.

The court of appeals found that the Commission's approach is consistent with the jurisdictional rules established by Congress in the FPA. 1 Pet. App. 27a-39a. The court rejected the argument of some States that the Commission may not regulate *unbundled* transmission of electric power that is associated with retail sales. At the same time, the court rejected the argument of some industry members that the Commission was required to apply the provisions of its standard open-access transmission tariff to *bundled* retail sales that historically have been regulated by the States.

1. Electric power systems have three basic functions: generating electric energy, transmitting the energy in bulk, and distributing it to consumers. Electric energy is generated at a generating station, and its voltage is increased ("stepped up") for transmission over high-voltage lines. After the energy travels to the vicinity of the end user over transmission lines, its voltage is reduced ("stepped down") for delivery over a local distribution system.[2]

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[2] See H. Rustebakke, *Electric Utility Systems and Practices* 1, 13-26 (4th ed. 1983) (describing typical power systems); Energy Information

Power systems in the continental United States are organized into three major networks, or "grids": the Eastern Interconnect, the Western Interconnect, and the Texas Interconnect (which covers most of Texas). Each grid is formed by high-voltage connections that are used to transfer electric energy from one utility on the grid to another. The Eastern Interconnect and the Western Interconnect are themselves connected. See *Electric Power Industry 2000* 13-14 & Fig. 7. Wholesale exchanges of power over the grids enable utilities to obtain electric energy from sources other than their own generating plants. The grids therefore provide utilities with access to lower-cost sources of power and improve the reliability of the utilities' services. *Id.* at 23. Today, "[v]irtually all" utilities in the continental United States are connected to a major grid. *Id.* at 14. Physically isolated power systems "have become a thing of the past." 2 Pet. App. 584a-585a.

Within each grid, electric energy follows the path of least resistance. The energy divides among multiple paths—which may or may not be owned by the utility that generates or sells the power—in order to find the path of least resistence between the generating station and the demand for power ("load"). 2 Pet. App. 612a & n.144. That flow of energy over parallel paths, known as "loop flow," is inevitable unless there is a direct ("radial") connection between the generation facility, at one end, and the load, at the other. See *ibid.*; R. Sarikas, *Introduction to Electrical Theory and Power Transmission* 56-57 (1995) (discussing radial transmission). Accordingly, "if any part of a supply of electric energy comes from outside of a state it is, or may be, present

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Administration, U.S. Dep't of Energy, *The Changing Structure of the Electric Power Industry 2000: An Update* (*Electric Power Industry 2000*) 9-16 (Oct. 2000) (available at <http://www.eia.doe.gov/cneaf/electricity/chg_stru_update/update2000.html>); see also *Connecticut Light & Power Co.* v. *FPC*, 324 U.S. 515, 519-521 (1945) (describing utility's facilities).

in every connected distribution facility." *Connecticut Light & Power Co.* v. *FPC*, 324 U.S. 515, 529 (1945).[3]

2. The interconnected nature of transmission grids, and their use in interstate commerce, have increased dramatically since 1935, when Congress enacted the relevant provisions of the FPA. At that time, the electric power industry was composed of largely self-sufficient utilities with their own generation, transmission, and distribution facilities. Vertically integrated electric utilities were deemed natural monopolies, and they sold their generation, transmission, and distribution services as a single bundled service to wholesale and retail customers, under the oversight of state regulators. 1 J.A. 190; 2 Pet. App. 578a; *Electric Power Industry 2000* 5. Because electric energy could not yet be transmitted efficiently over long distances, local utilities were not linked into large, centralized systems. See *United States* v. *Public Utils. Comm'n (California PUC)*, 345 U.S. 295, 302 (1953). Nevertheless, local monopolies did interconnect with neighboring utilities, and issues arose around exchanges of electric energy in interstate commerce, which were beyond the States' power to regulate. See, *e.g.*, *Public Util. Comm'n* v. *Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927). States likewise were unable to regulate the financial practices of the interstate holding companies that controlled many local utilities. The practices of those holding companies came under heavy criticism during the 1920s and early 1930s. See *Gulf States Utils. Co.* v. *FPC*, 411 U.S. 747, 758 (1973); *Electric Power Industry 2000* 5.

Congress enacted the Public Utility Act of 1935, ch. 687, 49 Stat. 803, to address those concerns. The Public Utility

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[3] Utilities typically contract to transmit power for each other "as if power flowed along one series of lines belonging to specific owners." 2 Pet. App. 612a. But "in reality power flows are rarely confined to a designated contract path." *Id.* at 612a n.144 (quoting *Indiana Mich. Power Co.*, 64 F.E.R.C. ¶ 61,184 (1993)).

Act "had two primary and related purposes." *Gulf States Utils.*, 411 U.S. at 758. First, Congress sought "to curb abusive practices of public utility companies by bringing them under effective control," which was the subject of Title I of the 1935 Act, known as the Public Utility Holding Company Act (§§ 1-33, 15 U.S.C. 79a through 79z-5.). See *Arcadia* v. *Ohio Power Co.*, 498 U.S. 73, 75 (1990). Second, Congress wanted "to provide effective federal regulation of the expanding business of transmitting and selling electric power in interstate commerce," which was the subject of the provisions of the 1935 Act that became Part II of the FPA. *Gulf States Utils.*, 411 U.S. at 758. Part II of the FPA (§§ 201-214, 16 U.S.C. 824-824m) conferred on the Commission's predecessor (the Federal Power Commission (FPC)) jurisdiction over specified activities of "public utilit[ies]," which as a practical matter meant investor-owned utilities as distinguished from, for example, municipal utilities. See 16 U.S.C. 824(e) and (f).[4]

In Section 201(a) of the FPA, 16 U.S.C. 824(a), Congress "declared that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest." Congress further declared that federal regulation of power generation, transmission of electric energy in interstate commerce, and the sale of electric energy at wholesale in interstate commerce, as provided in the Act, "is necessary in the public interest, such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States." 16 U.S.C. 824(a).

Section 201(b), the principal jurisdictional provision of Part II of the FPA, provides in pertinent part that the federal regulatory scheme "shall apply to the transmission of electric energy in interstate commerce and to the sale of

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[4] The Public Utility Act of 1935 also amended the hydroelectric power provisions now found in Part I of the FPA, 16 U.S.C. 791a *et seq.*

electric energy at wholesale in interstate commerce, but [with limited exceptions] shall not apply to any other sale of electric energy." 16 U.S.C. 824(b)(1). Section 201(b) further grants the Commission "jurisdiction over all facilities for such transmission or sale of electric energy," but generally denies the Commission jurisdiction "over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce." 16 U.S.C. 824(b)(1).

Section 201(c) provides that electric energy is transmitted in interstate commerce, for purposes of Part II, if it is "transmitted from a State and consumed at any point outside thereof" (but within the United States). 16 U.S.C. 824(c).

The substantive provisions of Part II prohibit, among other things, unjust or unreasonable rates, and undue discrimination "with respect to any transmission or sale subject to the jurisdiction of the Commission." 16 U.S.C. 824d(a) and (b) (FPA § 205(a) and (b)). Section 205(c) requires public utilities to file tariff schedules with the Commission, under such rules and in such form as the Commission may prescribe, showing their rates and terms for service, along with related contracts for service. 16 U.S.C. 824d(c). If the Commission finds that a public utility's rate "for any transmission or sale subject to the jurisdiction of the Commission," or any practice "affect[ing] such rate," is "unjust, unreasonable, unduly discriminatory or preferential," the Commission must prescribe a lawful rate or practice for the future. 16 U.S.C. 824e(a) (FPA § 206(a)).

Part II of the FPA was intended in part to "fill the gap" between federal and state jurisdiction created by *Public Utilities Commission* v. *Attleboro Steam & Electric Co.*, *supra*. See *New England Power Co.* v. *New Hampshire*, 455 U.S. 331, 340 (1982). In *Attleboro*, the Court had held that the Commerce Clause prohibited Rhode Island (or Massachusetts) from regulating the rates charged by a Rhode Island utility for electricity delivered to a separate

utility in Massachusetts, and that only Congress could regulate that wholesale transaction across state lines. See 273 U.S. at 84, 89-90. Part II of the Act filled the jurisdictional void created by *Attleboro* by establishing exclusive federal jurisdiction over such transactions. *New England Power*, 455 U.S. at 340.

When drafting the FPA, Congress understood that *Attleboro* and earlier cases established that the States could not regulate "any wholesale [power] transaction in interstate commerce." *FPC* v. *Southern Cal. Edison Co. (Colton)*, 376 U.S. 205, 213 n.8 (1964) (citing legislative history). Congress therefore extended federal regulation "to the sale of electric energy at wholesale in interstate commerce." 16 U.S.C. 824(b)(1) (FPA § 201(b)(1)). Distinguishing wholesale sales from retail sales drew "a bright line easily ascertained" between federal and state jurisdiction. *Colton*, 376 U.S. at 215; see 16 U.S.C. 824(d) ("sale of electric energy at wholesale" means "a sale of electric energy to any person for resale").

The *Attleboro* Court also had broadly held that "[t]he transmission of electric current from one State to another * * * is interstate commerce." 273 U.S. at 86. Accordingly, and consistent with its goal of simplifying the process of deciding whether a particular transaction is subject to federal or state regulation, see *Colton*, 376 U.S. at 214-216, Congress included in Section 201(b)(1) an additional grant of federal jurisdiction over "interstate transmission," without any language limiting that jurisdiction to wholesale transactions. 16 U.S.C. 824(b)(1); see S. Rep. No. 621, 74th Cong., 1st Sess., Pt. 1, at 17, 19 (1935) (noting that "[o]ther features of th[e] interstate utility business," besides interstate wholesale transactions, are "immune from State control," and that federal jurisdiction under Section 201(b) "includes interstate transmission where there is no sale").

At the same time, Congress intended to "tak[e] no authority from State commissions." *New England Power*, 455 U.S.

at 341 (quoting H.R. Rep. No. 1318, 74th Cong., 1st Sess. 8 (1935)) (emphasis omitted). It instead wanted to establish federal regulation "over those matters which cannot effectively be controlled by the States." S. Rep. No. 621, *supra*, Pt. 1, at 18. To that end, Congress provided that (as a general matter) the Commission's jurisdiction would not extend "to any other sale of electric energy" not made the subject of federal regulation in Section 201(b). 16 U.S.C. 824(b)(1). Furthermore, while the FPC would "have jurisdiction over all facilities for such transmission or sale of electric energy" within its jurisdiction,[5] as noted above the FPC was denied general jurisdiction "over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce." 16 U.S.C. 824(b)(1).[6]

3. By the 1970s, technological changes were beginning to erode the natural monopoly character of the vertically integrated utilities. Relatively small and inexpensive generating plants, generally fueled by natural gas, came over time to provide a cost-competitive alternative to the utilities' large, capital-intensive plants. See 1 J.A. 61-67; *Electric Power Industry 2000* 44-45. Continued improvements in transmission technologies made it possible to transmit electric power at higher voltages over longer distances, so that utilities with lower-cost plants or excess capacity could sell

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[5] The Senate report explained that "[j]urisdiction is asserted also over all interstate transmission lines whether or not there is sale of the energy carried by those lines," because "no steps can be taken to secure the planned coordination of this industry on a regional scale unless all of the facilities, other than those used solely for retail distribution, are made subject to the jurisdiction of the Commission." S. Rep. No. 621, *supra*, Pt. 1, at 48. In the final bill, Congress assigned jurisdiction over generation facilities to the States rather than to the Commission. 16 U.S.C. 824(b)(1).

[6] Congress likewise did not assert federal jurisdiction "over facilities for the transmission of electric energy consumed wholly by the transmitter." 16 U.S.C. 824(b)(1).

their power to customers as many as 1000 miles away. 1 J.A. 67-68.

Federal legislation accelerated competition in the generation of electric power. Congress enacted the Public Utility Regulatory Policies Act of 1978 (PURPA), Pub. L. No. 95-617, 92 Stat. 3117, to promote the development of alternative generating facilities that conserve traditional fossil fuels. 1 J.A. 68-70; see *FERC* v. *Mississippi*, 456 U.S. 742, 745-751 (1982). Among other things, PURPA required utilities to purchase power from the new alternative producers. See 16 U.S.C. 824a-3. The ensuing proliferation of alternative generation facilities demonstrated that vertically integrated public utilities need not be the only source of reliable power. 1 J.A. 70.

Other non-traditional sellers of electric power entered the market as well. They included independent power producers, which do not own any transmission or distribution facilities; affiliates of traditional utilities; and power marketers (such as Enron Power Marketing, Inc., the petitioner in No. 00-809), which sell power without owning the physical facilities used in connection with the sale. See 1 J.A. 71-73.

By the 1990s, problems involving access to the traditional utilities' transmission facilities had become a critical obstacle to the continued development of cheaper and more efficient sources of electric power. 1 J.A. 73-77. As the court of appeals explained in this case, "[p]ower generators not permitted to use utilities' transmission lines on reasonable terms have no way to transmit their power to customers." 1 Pet. App. 11a. In the Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776, Congress authorized the Commission to order utilities to provide transmission service, known as "wheeling," on a case-by-case basis for wholesale transactions. See 16 U.S.C. 824j, 824k (FPA §§ 211, 212); 1 J.A. 77-78. In practice, however, case-by-case consideration of wheeling requests entailed significant delays that limited the practical value of wheeling. 1 J.A. 81-83. So too, the Com-

mission's powers to require nondiscrimination when utilities voluntarily offered transmission services to other generators, and in connection with utility mergers, were limited because they could be exercised only in those contexts. See 1 J.A. 83-90.

4. a. By the mid-1990s, new generating facilities were producing power at as little as one-fifth of the cost of electricity generated by the traditional utilities' most expensive large plants. See 1 J.A. 97. Consumers (particularly large industrial users) who paid high electric rates were demanding access to lower-priced energy. 1 J.A. 97-98; see *Electric Power Industry 2000* 41-44.

The Commission responded by, among other things, issuing in March 1995 the notice of proposed rulemaking (2 Pet. App. 553a-644a) that led to Order No. 888.[7] The Commission proposed to require public utilities to offer nondiscriminatory transmission services for wholesale power sales under standard tariff terms. See *id.* at 559a-560a. In proposing "open access," the Commission reasoned that the traditional utilities' exercise of "market power through control of transmission is the single greatest impediment to competition" in bulk power markets. *Id.* at 558a. "Transmission is the vital link between sellers and buyers," the Commission explained. *Ibid.* "To achieve the benefits of robust, competitive bulk power markets, all wholesale buyers and sellers must have equal access to the transmission grid. Otherwise, efficient trades cannot take place and ratepayers will bear unnecessary costs." *Ibid.*

b. In April 1996, the Commission issued Order No. 888 (1 J.A. 42-430). Based on comments submitted in response to its notice of proposed rulemaking, the Commission found

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[7] The Commission also initiated other proceedings "[t]o address the fact that the electric industry is becoming more competitive, and to remove barriers that might inhibit a more competitive industry." 1 J.A. 91-92 (listing Commission initiatives).

that public utilities were commonly discriminating in violation of Section 205 of the FPA, 16 U.S.C. 824d, by denying access to their transmission networks or providing only inferior access. 1 J.A. 178-191. The Commission determined that such discrimination would likely "increase as competitive pressures continue to grow in the industry, unless the Commission acts now to prevent such practices." 1 J.A. 185.

Invoking its authority under Sections 205 and 206 of the FPA to remedy the unlawful discrimination it had identified, the Commission required "functional unbundling" of wholesale interstate transmission services. 1 J.A. 106. Specifically, a public utility that owns or controls transmission facilities must: (1) obtain transmission service for its own wholesale transactions under terms and conditions set out in the same tariff of general applicability that the utility offers to unaffiliated transmission customers; (2) separately state rates for wholesale generation and transmission, as well as for "ancillary services" (such as scheduling and correction of energy imbalances) that are needed for basic transmission service; and (3) when using the generally available transmission service, obtain information about its own transmission system by means of the same electronic information network that is made available to unaffiliated transmission customers. 1 J.A. 106-107. The Commission published a pro forma tariff containing minimum terms and conditions for nondiscriminatory open-access service, and required utilities to file tariffs containing those terms. 1 J.A. 52; see 1 J.A. 683-691 (pro forma tariff). The Commission declined, however, to order "a more intrusive and potentially more costly mechanism" for addressing discrimination—requiring utilities to divest their transmission facilities. 1 J.A. 108-109.[8]

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[8] The Commission additionally addressed the problem of "stranded costs," *i.e.*, a utility's inability to recoup its sunk costs when wholesale

The Commission estimated that, as a result of its open-access requirement, consumers would realize cost savings of approximately $3.8 to $5.4 billion per year. 1 J.A. 99. The Commission also noted that at least 12 States, responding to the same market opportunities for consumer savings and economic growth, had taken steps to give retail customers a choice of power suppliers. 1 J.A. 95 & n.101.

The Commission recognized that its unbundling rule implicated the allocation of jurisdiction over electric power services between the federal government and the States. In its lengthy analysis of jurisdictional issues, see 1 J.A. 384-430, the Commission concluded that when a public utility delivers electric energy in interstate commerce from a third-party supplier to a purchaser who will resell it, Section 201(b) of the FPA provides the Commission exclusive jurisdiction over the rates, terms, and conditions of that transmission service and any facilities used to provide it, even if those facilities might also be labeled "local distribution" facilities. 1 J.A. 425-426.

The Commission next concluded that it also has jurisdiction over unbundled transmission services, and the facilities used to provide those services, where the power is transmitted in interstate commerce to *retail* customers who have the ability to choose their energy supplier. The Commission found it particularly "compelling" that Section 201 gives the Commission jurisdiction over public utilities' transmission of energy in interstate commerce "without qualification" and, in particular, without any limitation to transmission in connection with wholesale transactions. 1 J.A. 348-349. The Commission considered the illustrative

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customers take advantage of open access to purchase power from other suppliers. In general, Order No. 888 allows a utility to recover such costs from a former customer if the utility is able to show a "reasonable expectation" that, absent open access, it would have continued to sell power to the customer. See 61 Fed. Reg. 21,540, 21,628-21,664 (1996).

example of a retail customer who purchases energy in interstate commerce from a distant supplier, using the lines of intermediate utilities as well as the lines of the customer's previous power supplier. 1 J.A. 427. In that situation, the Commission determined that it would have jurisdiction over all the transmission facilities used by the intervening utilities to deliver the power. *Ibid.*

"The more difficult issue," however, was "whether some portion of the facilities used to transmit energy from the transmitting utility in closest proximity to the end user (the former supplier of the bundled product) [would be] local distribution facilities," and thus expressly subject to state regulation under Section 201(b)(1). 1 J.A. 427. The Commission concluded that "in most, if not all circumstances, some portion will be local distribution facilities." *Ibid.*; see also 1 J.A. 348. The Commission therefore identified seven "indicators" it will consider in determining whether particular facilities a public utility uses for its unbundled transmission of power for sale at retail are transmission facilities subject to federal jurisdiction in that context, or instead are local distribution facilities subject to state jurisdiction. 1 J.A. 428-429; see 1 J.A. 354-358.[9] The Commission stated, however, that, in order to avoid regulatory conflict and to take advantage of state regulators' expertise, it would defer to recommendations by state commissions when applying its seven factors. 1 J.A. 356-357.

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[9] The seven indicators are that: (1) local distribution facilities are normally in close proximity to retail customers; (2) local distribution facilities are primarily radial in character; (3) power flows into local distribution systems, but rarely out; (4) power that enters a local distribution system is not reconsigned or transported on to some other market; (5) power entering a local distribution system is consumed in a comparatively restricted geographical area; (6) meters measure flows into the local distribution system; and (7) local distribution systems have reduced voltage. 1 J.A. 322.

The Commission emphasized that it was not claiming authority over any part of traditional arrangements in which the public utility bundles the retail sale of power together with the transmission of that power. "[W]hen transmission is sold at retail as part and parcel of the delivered product called electric energy," the Commission explained, "the transaction is a sale of electric energy at retail," and therefore regulated by the States under Section 201(b). 1 J.A. 349. But when electric energy is sold separately from transmission, potentially by another supplier, "the jurisdictional lines change." 1 J.A. 349-350. "In this situation," the Commission reasoned, "the state clearly retains jurisdiction over the sale of the power. However, the unbundled transmission service involves *only* the provision of 'transmission in interstate commerce' which, under the FPA, is exclusively within the jurisdiction of the Commission." 1 J.A. 350 (emphasis added).[10]

Relatedly, the Commission emphasized that in exercising jurisdiction over the rates, terms, and conditions of the unbundled transmission of power for sale at retail, it was not asserting jurisdiction to order utilities to unbundle their retail services, or to order transmission to any retail consumer. 1 J.A. 350; see also 1 J.A. 226-227 (finding unbundling of retail transmission and generation unnecessary to eliminate discrimination and declining to order it for that reason and due to jurisdictional concerns). Indeed, the Commission noted, Section 212(h) of the FPA, 16 U.S.C. 824k(h), "clearly prohibits" the Commission from ordering

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[10] In practice, a power supplier that competes with the local public utility to serve an ordinary retail consumer typically serves that consumer by: generating or purchasing the necessary power; purchasing federally tariffed transmission service from the local utility (and potentially other utilities as well) to carry the power in bulk; purchasing distribution service from the local utility to deliver the power; and selling the power in a state-regulated retail transaction. The consumer would choose between energy suppliers based on the price and quality of their delivered power.

transmission to an ultimate consumer. 1 J.A. 350.[11] The Commission explained that its jurisdiction attaches only if the utility provides unbundled transmission in interstate commerce for energy sold at retail. *Ibid.* Therefore, a utility need not file a federal tariff for transmission in connection with retail sales unless it is ordered by the State to provide such transmission, or it offers that service voluntarily. *Ibid.*

The Commission observed that its jurisdiction over the rates, terms, and conditions of unbundled transmission would not affect the States' authority to regulate matters traditionally within their jurisdiction, such as the siting of public utilities' facilities, standards for local service reliability, and the availability of local retail electric service. 1 J.A. 351-353 & nn. 543, 544. Jurisdiction over such matters remains with the States, which "have jurisdiction in all circumstances over the service of delivering energy to end users." 1 J.A. 355.

c. In Order No. 888-A (excerpted at 2 Pet. App. 371a-551a and 2 J.A. 517-791), the Commission addressed petitions for rehearing of Order No. 888 and reaffirmed and clarified its jurisdictional holdings. See 2 Pet. App. 453a-456a; 2 J.A. 580-611. The Commission rejected the argument that, by asserting jurisdiction over all unbundled transmission in interstate commerce, it was "taking away" state jurisdiction over transmission in connection with retail sales. In the Commission's view, "[t]he fact that states historically regulated most retail transmission service as a part of a bundled retail power sale is * * * the practical result of the way electricity has historically been bought and sold," but power markets are "rapidly changing." 2 J.A. 593. The Commission explained that it was not intruding upon the States' historical jurisdiction, but rather applying the FPA

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[11] Section 212(h)(1) prohibits the Commission from issuing orders that are "conditioned upon or require the transmission of electric energy * * * directly to an ultimate consumer." 16 U.S.C. 824k(h)(1).

to a new paradigm—not specifically contemplated by Congress in 1935—in which transmission service is provided in a transaction that is separate from the retail sale of energy, and sometimes by a separate provider. In "[t]oday's unbundled world," the Commission concluded, the States' jurisdiction over retail sales of electric energy does not necessarily include jurisdiction over associated transmission. 2 J.A. 593-595.

5. The court of appeals affirmed Orders No. 888 and 888-A in all relevant respects. 1 Pet. App. 3a-121a. In particular, the court rejected arguments by some States that the Commission asserted too much jurisdiction over unbundled transactions, and from some industry members that the Commission asserted too little jurisdiction over bundled transactions. *Id.* at 27a-35a.

The state petitioners argued that Section 201 of the FPA gives the Commission authority to regulate transmission of electric energy only when the energy is consumed in a State other than the one in which it was generated, and only when the transmission has not historically been regulated by the States. They therefore maintained that the Commission exceeded its statutory authority by exercising jurisdiction over the transmission component of unbundled retail power transactions in interstate commerce. 1 Pet. App. 30a.

Addressing those arguments, the court observed that "[b]oth FPA § 201(a) and (b) clearly and unambiguously confer upon [the Commission] jurisdiction over the 'transmission of electric energy in interstate commerce.'" 1 Pet. App. 32a. Furthermore, the court of appeals explained, in *Jersey Central Power & Light Co.* v. *FPC*, 319 U.S. 61 (1943), and *FPC* v. *Florida Power & Light Co.*, 404 U.S. 453 (1972), this Court upheld assertions of federal jurisdiction over public utilities based upon their interstate interconnection and the resulting energy flows. 1 Pet. App. 32a-34a. Following those decisions, the court of appeals "conclude[d] that the FPA gives [the Commission] the authority

to regulate [the unbundled] transmissions at issue here, whether retail or wholesale." *Id.* at 34a. In the alternative, and even if this Court's decisions and the text of the FPA did not clearly compel the Commission's assertion of jurisdiction over the interstate transmission component of unbundled retail transactions, the court stated that it would be "hard pressed" to find the Commission's construction of the FPA "unreasonable or impermissible," and, accordingly, the court would defer to the Commission's construction under *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843 (1984). 1 Pet. App. 35a.

The court of appeals also rejected the private petitioners' arguments that the Commission erred by not asserting jurisdiction over transmission in bundled as well as unbundled retail transactions, and, in doing so, subjecting retail service that currently is bundled to the rates, terms, and conditions of the pro forma open-access tariff set out in Order No. 888. 1 Pet. App. 30a-31a, 35a. The court explained that Section 201 of the FPA clearly establishes federal jurisdiction over transmission, and clearly preserves state jurisdiction over local distribution facilities and retail sales, but "[t]he statute is much less clear about exactly where the lines between those activities are to be drawn." *Id.* at 35a. In the court's view, "[a] regulator could reasonably construe transmissions bundled with generation and delivery services and sold to a consumer for a single charge as either transmission services in interstate commerce or as an integral component of a retail sale." *Ibid.* The Commission's decision to treat the transmission component of bundled retail sales as part of the retail sale of energy therefore "represents a statutorily permissible policy choice to which we must also defer under *Chevron*." *Ibid.*

The court of appeals next upheld, against challenge by the petitioner States, the Commission's exercise of exclusive jurisdiction over the transmission of power to a wholesale purchaser, to the extent it occurs over facilities that would

be state-regulated "local distribution" facilities in the context of a retail transaction. 1 Pet. App. 35a-39a. The court determined that Section 201 "makes clear that all aspects of wholesale sales," including associated transmission and transmission facilities, "are subject to federal regulation, regardless of the facilities used." *Id.* at 38a.

Finally, the court of appeals upheld the Commission's approach to distinguishing local distribution facilities from transmission facilities in the context of unbundled retail transactions. 1 Pet. App. 39a. The court pointed out that while Section 201(b)(1) assigns the States jurisdiction over "facilities used in local distribution," Congress did not define this statutory phrase. *Ibid.* Because the Commission's multi-factor approach to interpreting and applying "undefined and ambiguous" statutory language was reasonable, the court concluded that it warrants *Chevron* deference. *Ibid.*

SUMMARY OF ARGUMENT

I. A. Section 201(b)(1) of the FPA authorizes the Commission to regulate "the transmission of electric energy in interstate commerce." 16 U.S.C. 824(b)(1). Because electric energy "commingles" in interconnected power systems without regard to its source or the ultimate user of the energy, see *FPC* v. *Florida Power & Light Co.*, 404 U.S. 453, 463 (1972), Congress's express grant of authority over interstate transmission allows the Commission to regulate all transmission over power systems that are connected to an interstate power grid. New York never asked the Commission to consider its factual argument that the electric energy of a particular generating station is used only by those consumers nearest to the station, and that argument is inconsistent with the analysis uniformly applied in prior precedent.

B. New York's claim that federal jurisdiction over interstate transmission extends only to transmission associated

with wholesale sales of energy likewise conflicts with the text of Section 201(b). Whereas Congress expressly confined the Commission's jurisdiction over *sales* of energy in interstate commerce to wholesale sales, the Commission's jurisdiction over interstate *transmission* is not similarly qualified. This Court's interpretation of the analogous jurisdictional provision of the Natural Gas Act, 15 U.S.C. 717(b), confirms that the Commission's jurisdiction over interstate transmission is in addition to, and is not limited by, its jurisdiction over wholesale sales of energy. *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 636 (1972).

The FPA does reserve jurisdiction over non-wholesale sales of energy, and over facilities used in the local distribution of energy, to the States. But those carve-outs from federal jurisdiction do not limit the Commission's jurisdiction over interstate transmission services.

C. Congress's declaration of policy in Section 201(a) of the FPA, 16 U.S.C. 824(a), further confirms that the Commission has jurisdiction over wholesale sales of energy and, separately, over interstate transmission of energy (whether for wholesale or retail sales). Although New York relies heavily on the FPA's legislative history to support its contrary argument, New York has not identified a single statement that the States would regulate interstate transmission if such transmission were offered separately from electric energy and consumers had a choice of energy suppliers. Because the legislators who drafted the FPA deemed vertically integrated public utilities to be natural monopolies, they did not contemplate the provision of transmission service for retail transactions separately from retail sales of energy.

Relying on cases addressing federal preemption of traditional state regulation, New York argues that because Congress did not contemplate unbundled transmission in connection with retail sales of energy, it did not make a sufficiently clear assertion of federal jurisdiction over that

service. The absence of any historical tradition of state regulation of the new service of unbundled transmission for retail transactions renders inapposite the cases on which New York relies. In any event, Section 201(b)(1) does unequivocally assign the Commission jurisdiction over "the transmission of electric energy in interstate commerce." 16 U.S.C. 824(b)(1).

D. Order No. 888 leaves traditional state regulation undisturbed. The Commission explained in Order No. 888 that its rules would not divest the States of jurisdiction over retail sales of electric energy or local distribution facilities, and that the States retain jurisdiction over other local matters such as power production, siting of facilities, customer service, and local service reliability. The current energy crisis in California, moreover, does not support New York's policy arguments against Order No. 888. That situation involves supply and demand factors and rules governing power markets that are unrelated to the allocation of jurisdiction over unbundled transmission service.

II. Although Congress clearly intended to assign the Commission jurisdiction over transmission in interstate commerce when that transmission is separate from a sale of electric energy, nothing in the FPA clearly resolves the question of whether—in a market where energy can potentially be purchased from suppliers other than the traditional local utility—a public utility's bundled retail sale of energy and associated transmission should be treated as a single transaction subject to state regulation, or, instead, as both a transmission transaction subject to federal regulation and a retail sale of energy subject to state regulation. The Commission reasonably resolved that ambiguity in the statute by adhering to 65 years of practice under the FPA, and holding that transmission provided as part of a bundled retail sale of electric energy is subject to state jurisdiction.

ARGUMENT

Under the Commission's jurisdictional holding, traditional state regulation is not disturbed, but the Commission is able to apply its open-access tariff rules uniformly to all unbundled interstate transmission, thus preventing public utilities from abusing their control over the transmission facilities that are needed to support competitive power markets. Wholesale customers, and retail customers in States that have authorized competition in the retail market, can be served over interstate transmission grids on a nondiscriminatory basis, giving them a meaningful opportunity to consider alternative suppliers. But when an incumbent utility operates as a traditional monopoly utility and sells generation, transmission, and distribution to the consumer in a bundled package, the State will continue to regulate that bundled retail service. The Commission's interpretation and application of the FPA in these circumstances establishes a sound and workable regulatory framework that fully complies with the text of the Federal Power Act and the underlying legislative intent.

I. THE COMMISSION CORRECTLY INTERPRETED THE FEDERAL POWER ACT AS ESTABLISHING FEDERAL JURISDICTION OVER UNBUNDLED TRANSMISSION OF ELECTRIC ENERGY IN INTERSTATE COMMERCE

New York, as petitioner in No. 00-568, argues that the Commission is "attempting to preempt" (N.Y. Pet. Br. 10) state jurisdiction over transmission that historically has been regulated by the States, and that the FPA precludes federal regulation of any aspect of retail service. Those arguments are incorrect.

A. Transmission By A Utility That Utilizes An Interstate Grid Is "In Interstate Commerce"

The plain language of Section 201(b)(1) of the FPA establishes federal jurisdiction over "the transmission of electric energy in interstate commerce" and "all facilities for such transmission," but excludes from the Commission's jurisdiction "facilities used * * * only for the transmission of electric energy in intrastate commerce." 16 U.S.C. 824(b)(1). Section 201(c) provides that "electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof," but within the United States. 16 U.S.C. 824(c). Therefore, subject to exclusions that preserve state jurisdiction over retail sales of energy and over local distribution facilities (which we discuss in Part I.B., below), Congress vested the Commission with jurisdiction over all transmission of electric energy that involves origination and consumption in different States, and over all the facilities used for such transmission. That express conferral of authority on the Commission defeats New York's claim of state jurisdiction.

1. New York argues (N.Y. Pet. Br. 36-37, 43-46) that Section 201(b)'s textually broad assignment of jurisdiction over interstate transmission to the Commission is illusory, because the Commission may not exercise jurisdiction over a public utility's transmission service under that provision unless it "show[s] that essentially every electron used by a retail customer in each state [served by the utility] * * * is generated in a different state" (*id.* at 45 n.27). This Court's decisions foreclose New York's exceedingly narrow view of the Commission's transmission jurisdiction and establish the very different rule that when utilities connect their facilities to an interstate grid, their electricity presumptively flows "in interstate commerce" for purposes of Section 201. See 1 J.A. 389 ("[T]he highly integrated nature of the electric

system * * * results in most transmission of electric energy being 'in interstate commerce.'").

In *Connecticut Light & Power Co.* v. *FPC*, 324 U.S. 515 (1945), the Court explained that the "[t]echnology of the business is such that if any part of a supply of electric energy comes from outside of a state it is, or may be, present in every connected distribution facility." *Id.* at 529. Accordingly, the Court observed in *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission*, 461 U.S. 375, 381 (1983), that when a utility is "ultimately tied into a multicompany and multistate 'grid,' * * * it is difficult to say with any confidence that the power [the utility] provides to its [customers] at any particular moment originated entirely within the State." See also *New England Power Co.* v. *New Hampshire*, 455 U.S. 331, 336 (1982) (when the utility is connected to a regional transmission network, it is "impossible to contain" power generated by the utility within the State where it is generated).

A utility might attempt to take extraordinary measures to isolate its operations from interstate transmission. In *Connecticut Light & Power*, for example, federal jurisdiction was put in doubt when "the [utility] rearranged its operations with intent to cut every connection and discontinue every facility whose continued operation would render it subject to the Federal Power Commission's control." 324 U.S. at 518-519. But such a quarantine from the interstate grid must be complete to be effective for jurisdictional purposes. In *Jersey Central Power & Light Co.* v. *FPC*, 319 U.S. 61 (1943), Jersey Central was deemed to use its facilities "for the transmission of electric energy across state lines" even though it had no direct connection to any utility outside New Jersey, on the ground that one of Jersey Central's in-state customers exchanged power (some of which came from Jersey Central) with a New York company. *Id.* at 63-67. Similarly, in *FPC* v. *Florida Power & Light Co.*, 404 U.S. 453 (1972), Florida Power was "unusually insular

and independent" as a result of Florida's "peninsular nature" and the risk of hurricane damage to transmission lines. But although Florida Power had no direct connection with any out-of-state utility, it did connect with an adjacent Florida utility that, in turn, connected to a Georgia utility and an interstate power grid. *Id.* at 456-457. The Court held that Florida Power transmitted electricity in interstate commerce if any of its power reached the Georgia company, or vice-versa, "no matter how small the quantity." *Id.* at 454-455, 458, 461 n.10. Because Florida Power's energy "commingled" with the Georgia company's energy by virtue of the connection through the second Florida utility, this Court held that Florida Power transmitted energy in interstate commerce and was subject to the Commission's jurisdiction. *Id.* at 458, 461, 463.

New York asserts (N.Y. Pet. Br. 37-39, 40, 43-44) that *Jersey Central* and *Florida Power* addressed only the question of whether the public utility itself was subject to Commission jurisdiction, and did not hold that every transmission of electricity by an interconnected utility is subject to federal regulation. New York further suggests that considering transmissions to be "in interstate commerce" on the basis that the utility is connected to an interstate grid renders Section 201(c) of the FPA "[n]early [n]ugatory," because virtually all transmission would be across state lines. *Id.* at 44-45.

New York ignores that the Commission's open-access requirements apply only to "unbundled transmission *in interstate commerce.*" 1 J.A. 384 (emphasis added); see 2 J.A. 597 (Order No. 888-A) (asserting jurisdiction over "retail wheeling in interstate commerce that is ordered by a state or that is provided voluntarily"). The Commission acknowledged that it has no jurisdiction under Sections 205 and 206 of the FPA over unbundled retail transmission in Alaska, Hawaii, and much of Texas, "since transactions in those areas are intrastate." 1 J.A. 349 n.541. In theory,

moreover, any public utility could attempt to show that particular transmissions involve exclusively intrastate energy. Cf. *Florida Power*, 404 U.S. at 457 n.8, 469 (discussing "tracing studies" and expert testimony used to establish federal jurisdiction); N.Y. Pet. Br. 45 n.28 (noting the theoretical possibility of closed, "radial" transmission systems).

The important point for present purposes, however, is the practical reality that physically isolated utilities "have become a thing of the past." 2 Pet. App. 585a. As utilities have connected to interstate networks, their electric energy has commingled with other energy in the networks, "just as molecules of water from different sources (rains, streams, etc.) would be commingled in a reservoir." *Florida Power*, 404 U.S. at 461. Consequently, the energy the interconnected utilities sell from the interstate grids is in interstate commerce. See *ibid.*; cf. *California* v. *Lo-Vaca Gathering Co.*, 379 U.S. 366 (1965) (commingling of natural gas within Commission jurisdiction with gas outside of Commission's jurisdiction establishes Commission jurisdiction over all of the gas). Even New York's amicus recognizes that fact. Cal. Br. 11 ("[W]hen any part of the electricity moves across state lines, transmission all the way to the retail customer is transmission in interstate commerce.").

The overwhelmingly interstate nature of electrical transmission therefore has to do with the evolution of electric power systems, not Order No. 888. Indeed, Congress was well aware in 1935 that the Act gave the FPC broad jurisdiction over interconnected utilities and their transmission services.[12]

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[12] See S. Rep. No. 621, 74th Cong., 1st Sess., Pt. 2, at 5 (1935) (minority views) (stating that, because "it is almost always impossible to separate * * * transmission facilities between those used only for energy sold interstate and energy sold intrastate," the FPA would cause "almost complete displacement of State jurisdiction over electric utilities"); 00-568

New York concedes that the view "that all transactions affect the entire grid * * * is arguably accurate, from a theoretical standpoint" (N.Y. Resp. Br. 25), but nevertheless suggests that "[m]ost electricity used in the United States is generated in the state where it is used" (N.Y. Pet. Br. 5). See also *id.* at 45 n.28; N.Y. Resp. Br. 25-26. That argument echoes an argument this Court implicitly rejected in *Florida Power*. See 404 U.S. at 462 (noting Florida Power's argument that "all of [its] power will be exhausted * * * before the point, further down the line, where Georgia's load intervenes"); *id.* at 469 (upholding Commission finding that energy traveled across the Florida border). New York, moreover, did not present its factual claims about network operations to the Commission or to the court of appeals, and they therefore are not properly before this Court. See *FPC* v. *Sunray DX Oil Co.*, 391 U.S. 9, 36 n.21 (1968); *Glover* v. *United States*, 121 S. Ct. 696, 701 (2001); see also 16 U.S.C. 825*l*(b) (barring judicial review of claims not raised in petition for rehearing). In any event, even if a particular utility could show that its transmission service involves *mostly* intrastate energy, that would not defeat federal jurisdiction, for "Congress has not 'conditioned the jurisdiction of the Commission upon any particular volume or proportion of

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Pet. App. L-35 to L-36 (testimony of FPC Solicitor DeVane that the draft legislation "gives the Commission control over interstate transmission facilities" and that, "not withstanding 90 percent of the business is intrastate and 10 percent is interstate, this bill gives [the FPC] the power to regulate"); *Public Utilities Holding Co. Act of 1935: Hearings on S. 1725 Before the Senate Comm. on Interstate Commerce*, 74th Cong., 1st Sess., Pt. 2, at 241 (1935) (testimony of Solicitor DeVane that interconnection between power systems "would tend to greatly increase the percentage" of power transferred across state lines); Enron Pet. Br. 30 n.20 (quoting House committee hearings). In *Florida Power*, Justice Douglas stated in dissent that, in light of the Court's holding, "every privately owned interconnected facility in the United States (except for those isolated in Texas) is within the FPC's jurisdiction." 404 U.S. at 471.

interstate energy involved.'" *Florida Power*, 404 U.S. at 461 n.10 (quoting *Connecticut Light & Power*, 324 U.S. at 536). Indeed, under the express terms of Section 201(b)(1), transmission facilities (other than local distribution facilities) are within the Commission's jurisdiction unless they are used "*only* for the transmission of electric energy in intrastate commerce." 16 U.S.C. 824(b)(1) (emphasis added).

B. Congress Did Not Exclude Unbundled Retail Transmission From The Commission's Jurisdiction Over Interstate Transmission

1. New York further argues (N.Y. Pet. Br. 30-31) that the Commission's jurisdiction over interstate transmission is limited to transmission provided in connection with wholesale transactions.[13] Section 201(b)(1), however, states that "[t]he provisions of this subchapter shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce." 16 U.S.C. 824(b)(1). As the court of appeals held, that plain language "clearly and unambiguously confer[s] upon [the Commission] jurisdiction over the 'transmission of electric energy in interstate commerce,'" *in addition to* "the sale of electric energy at wholesale in interstate commerce." 1 Pet. App. 32a, 34a.

Decisions under the Natural Gas Act of 1938, 15 U.S.C. 717 *et seq.*, confirm that the Commission's jurisdiction over wholesale sales of energy *supplements* the Commission's jurisdiction over transmission, rather than limiting that jurisdiction. See 2 J.A. 420-425. Because large portions of

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[13] That argument is outside the scope of the question on which this Court granted certiorari. See Sup. Ct. R. 14(1)(a). Question 1 of New York's petition in No. 00-568, on which this Court granted certiorari, raised only the question of the Commission's power to assert jurisdiction over "*intrastate* retail transmissions of electric energy" transmitted "from generators to retail customers in the same state." New York Pet. i (emphasis added).

the Natural Gas Act "are in all material respects substantially identical" to the FPA, this Court "cit[es] interchangeably decisions interpreting the pertinent sections of the two statutes." *Arkansas La. Gas Co.* v. *Hall*, 453 U.S. 571, 577 n.7 (1981). Moreover, as with the FPA, the Natural Gas Act was drafted in a time of bundled retail sales. See 1 J.A. 347, 422.[14] Section 1(b) of the Natural Gas Act, which is relevant here, closely tracks Section 201(b) of the FPA: Commission jurisdiction extends to "the transportation of natural gas in interstate commerce, [and] to the sale in interstate commerce of natural gas for resale," but "not * * * to any other transportation or sale of natural gas or to the local distribution of natural gas, or to the facilities used for such distribution." 15 U.S.C. 717(b). In *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621 (1972), the Court explained that Section 1(b) establishes federal jurisdiction over: "(1) the transportation of natural gas in interstate commerce; (2) its sale in interstate commerce for resale; and (3) natural gas companies engaged in such transportation or sale." *Id.* at 636 (quoting *Panhandle E. Pipeline Co.* v. *Public Serv. Comm'n*, 332 U.S. 507, 516 (1947)). Accordingly, the Natural Gas Act "applies to interstate 'transportation' regardless of whether the gas transported is ultimately sold retail or wholesale." *Ibid.* (quoting *FPC* v. *East Ohio Gas Co.*, 338 U.S. 464, 468 (1950)); see *id.* at 637-638. New York's argument that the Commission has jurisdiction over interstate transmission under the FPA only if the electric energy being transmitted is sold at wholesale fails under a parallel analysis.

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[14] As under the FPA, the Commission has implemented an open-access program under the Natural Gas Act. That program is similar in many respects to the open-access program established by Order No. 888. See generally *United Distribution Cos.* v. *FERC*, 88 F.3d 1105 (D.C. Cir. 1996) (addressing jurisdictional and other challenges to open-access program under Natural Gas Act).

2. The Commission recognized (see generally 1 J.A. 384-430) that Congress, having established in Section 201(b)(1) "broad" federal jurisdiction over interstate transmission, wholesale sales, and facilities for such transmission and sales, then imposed specific limits on the reach of that grant in order "to respect state rights and local institutions." *Connecticut Light & Power*, 324 U.S. at 530. As relevant here, Congress carved out from the Commission's sphere, and reserved to the States, jurisdiction over (1) "any other sale of electric energy" and (2) "facilities used in local distribution." 16 U.S.C. 824(b)(1). Neither of those exclusions denies the Commission the authority to regulate unbundled interstate transmission in connection with retail sales.

a. "*Any Other Sale of Energy.*" New York does not suggest that transmission in connection with retail sales is an "other sale of electric energy" for purposes of Section 201(b)(1). That reservation of state jurisdiction refers back to Congress's assertion, earlier in Section 201(b)(1), of federal jurisdiction over "the sale of electric energy at wholesale in interstate commerce." 16 U.S.C. 824(b)(1). Together, those two provisions establish the "bright line" between wholesale and retail sales of which this Court has spoken. *Colton*, 376 U.S. at 215; see S. Rep. No. 621, 74th Cong., 1st Sess., Pt. 1, at 48 (1935) (noting that Section 201(b) establishes federal jurisdiction over wholesale sales but not retail sales). The "sales" provisions simply do not address the Commission's jurisdiction over transmission. Transmission consists of transporting energy in bulk from generating stations, typically to the local distribution facilities that serve most end users; although transmission service may be sold with energy on a bundled basis, transmission is not itself a sale of energy. See 1 J.A. 349-350, 387-388.

b. "*Facilities Used In Local Distribution.*" The Commission identified seven indicators that will guide its determination whether particular facilities of a public utility are transmission facilities subject to federal jurisdiction, or,

alternatively, local distribution facilities subject exclusively to state jurisdiction when used in connection with a retail sale of energy. See 1 J.A. 425-430. Without challenging the specifics of that test, California suggests (Br. 7-17) that, when Congress assigned jurisdiction over "facilities used in local distribution" to the States, it disclaimed federal regulation of each and every facility, including transmission facilities, that supports retail electric service. See also N.Y. Pet. Br. 31-33.

California's theory cannot be reconciled with the text of Section 201(b)(1). As discussed above, that section limits the Commission's jurisdiction over interstate sales of energy to sales "at wholesale," but does not similarly limit the Commission's jurisdiction over interstate transmission and transmission facilities. 16 U.S.C. 824(b)(1). If Congress had intended to limit the Commission's transmission jurisdiction to transmission in connection with wholesale sales, it would have done so explicitly, just as it did when limiting the Commission's sales jurisdiction to wholesale transactions. Congress would not have hidden its intent regarding transmission service associated with retail sales in a reference to "facilities used in local distribution." 16 U.S.C. 824(b)(1).[15]

California's argument that all facilities used to provide transmission in connection with retail sales are "used in local distribution" also is contrary to industry usage of the term "distribution," which refers to lower-voltage circuits that provide electricity to customers over relatively short distances. Compare H. Rustebakke, *supra*, at 122 (defining "transmission") with *id.* at 199 (defining "distribution sys-

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[15] If Congress had intended to limit the Commission's transmission jurisdiction as California suggests, it logically would have begun Section 201(b) by saying something like: "The provisions of this subchapter shall apply to the sale of electric energy at wholesale in interstate commerce and to the transmission of electric energy in interstate commerce for such sales * * * ."

tem"). Indeed, legislative history that New York quotes selectively (N.Y. Pet. Br. 33), when read in full, confirms that Congress drew a jurisdictional line based on the physical distinction between transmission systems and local distribution facilities. See 00-568 Pet. App. L-32 (testimony of FPC Solicitor DeVane that "[t]he bill does not give the Commission any jurisdiction whatever over facilities used in local distribution or the transmission facilities that are used in connection with such local distribution, *unless they are also a part of the facilities that are used in interstate commerce.*") (emphasis added).

This Court's cases also foreclose California's claim that transmission facilities used for retail sales are local distribution facilities. In *Connecticut Light & Power*, the Court reviewed an FPC determination that local distribution begins where "the function of conveyance in bulk over a distance, which is the essential characteristic of 'transmission,' is completed and the process of subdividing the energy to serve ultimate consumers * * * is begun." 324 U.S. at 533 (quoting FPC order). Although the Court found the FPC's rationale for its jurisdictional line insufficient, both the majority and the dissenting Justices agreed with the FPC that distinguishing transmission facilities from facilities used in local distribution was a matter of identifying an "exact point" of demarcation in the network. *Id.* at 534, 539, 541. Similarly, the Court held in *Colton* that deciding whether facilities are used in local distribution implicates "the specialized experience of the FPC in determining such questions." 376 U.S. at 210 n.6. Neither case suggests that a facility is "local" simply because it is used in connection with a retail transaction.

FPC v. *East Ohio Gas Co.* likewise undermines California's theory that the retail or wholesale nature of the sale of energy determines whether facilities are used in local distribution. The natural gas company in that case sold gas recovered from wells in various States, but the company had

facilities only in Ohio and sold its gas only at retail within Ohio. 338 U.S. at 467-468. The company argued that all of its facilities were local distribution facilities subject to exclusive state jurisdiction under Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b). 338 U.S. 468-469. The Court rejected that argument, holding that federal jurisdiction extends to the transportation of gas in interstate commerce through high-pressure transmission lines for delivery to retail customers, and that local distribution does not begin until the point where the gas enters local mains. *Id.* at 468-470. The fact that the company sold "direct to consumers rather than for resale" was "immaterial." *Id.* at 473.

Contrary to California's contention (Br. 24-25), *East Ohio* remains good law. In *Louisiana Power & Light*, the Court explicitly relied upon *East Ohio*'s jurisdictional analysis and quoted it at length. 406 U.S. at 636-637 & n.13. And *East Ohio* has been "repudiated" (Cal. Br. 24) only in the sense that Congress later amended the Natural Gas Act by adding a new provision that effectively overturned *East Ohio* in the natural gas context. See *General Motors Corp.* v. *Tracy*, 519 U.S. 278, 293 (1997). Congress has never made a parallel amendment to the FPA.[16] Finally, there is no inconsistency between the rule of *East Ohio* and *Pennsylvania Gas Co.* v. *Public Service Commission*, 252 U.S. 23 (1920). See Cal. Br. 9-10, 24-25. *Pennsylvania Gas*, which predates both the FPA and the Natural Gas Act, stands for the proposition that "the furnishing of natural gas to local consumers within [a] city" is local service subject to state regulation. 252 U.S.

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[16] The so-called "Hinshaw Amendment" added a new Section 1(c), 15 U.S.C. 717(c), to the Natural Gas Act. Section 1(c) provides, among other things, that facilities used in the transportation of natural gas in interstate commerce, or in the sale of natural gas in interstate commerce for resale, are exempt from the Commission's jurisdiction if the gas is received within or at the boundary of a State and is consumed within the State, and if the State has asserted jurisdiction. New York is, in effect, asking this Court to write a similar amendment into the FPA.

at 31. Consistent with that principle, Order No. 888 reaffirmed that the States have jurisdiction over sales of energy to retail customers. See 1 J.A. 349-350.

C. The Commission's Jurisdictional Holding Is Consistent With Congress's Purposes In Enacting Section 201

1. New York places great weight on Section 201(a) of the FPA, which "declare[s] * * * that Federal regulation * * * of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States." 16 U.S.C. 824(a); see N.Y. Pet. Br. 16, 18-26, 27-28, 30-34.

Congress's declaration of policy does not trump the specific jurisdictional rules set out in Section 201(b). In *FPC* v. *Southern Cal. Edison Co.*, 376 U.S. 205 (1964), the Court explained that whereas "Section 201(b) embodies a clear grant of power," Section 201(a) is "merely a 'policy declaration . . . of great generality'" that "cannot nullify a clear and specific grant of jurisdiction, even if the particular grant seems inconsistent with the broadly expressed purpose." *Id.* at 215 (quoting *Connecticut Light & Power*, 324 U.S. at 527).

In any event, Section 201(a) states the same rule as Section 201(b): the Commission has jurisdiction over wholesale sales of energy in interstate commerce and, independently, over the transmission of energy in interstate commerce. Even if Section 201(a)'s "ambiguous reference to 'matters . . . subject to regulation by the States'" (*United States* v. *Pub. Utils. Comm'n (California PUC)*, 345 U.S. 295, 308-309 (1953)) were read as covering all matters that traditionally have been regulated by the States (see N.Y. Pet. Br. 27-28), that would not help New York. The States have *not* traditionally regulated unbundled interstate transmission associated with retail sales.

In that regard, it is important to emphasize the fallacy of New York's repeated assertions (N.Y. Pet. Br. 8-9, 27, 35) that the only difference between today's unbundled transmission and the bundled retail service that Congress had in mind in 1935 "is a change in bill format." *Id.* at 8; see also Enron Br. 18, 37. As used in Order No. 888, "unbundling" is one aspect of the Commission's broader concept of "open access," under which public utilities are required to provide nondiscriminatory access to their transmission systems so that purchasers of power have a meaningful opportunity to obtain power across the grid from alternative suppliers. 1 J.A. 50-52, 106. The Commission has not asserted jurisdiction over unbundled retail transmission simply because a public utility *bills* its retail customers separately for generation and transmission. Rather, the Commission's open-access tariff and its jurisdiction over rates, terms, and conditions of interstate transmission in connection with retail sales apply when the traditional, bundled transaction "is broken into two products that are sold separately (perhaps by two different suppliers: an electric energy supplier and a transmission supplier)," and the customer can choose an energy supplier. 1 J.A. 349-350; see 2 J.A. 593-594. The defining difference between bundled retail service and unbundled services is the customer's opportunity to choose a different power supplier if the local public utility fails to offer a competitive price and quality of service. And as the Commission recognized, that opportunity to choose is not meaningful unless alternative suppliers have access to essential transmission facilities on nondiscriminatory terms and conditions. 2 Pet. App. 558a.

New York also suggests (N.Y. Pet. Br. 24 n.12, 36, 40) that Section 206(d) of the FPA, 16 U.S.C. 824e(d), shows that Congress did not intend to give the Commission jurisdiction to set rates for any services associated with retail sales of energy. See also Cal. Br. 17-18. Section 206(d) authorizes the Commission to "investigate and determine the cost of the

production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy." 16 U.S.C. 824e(d). That authority would be useful, for example, when a single public utility generates electric power in one State and sells it to retail customers in another State, or when a single utility's service area straddles a state line.[17] Consistent with Section 206(d), Order No. 888 respects the States' "authority to establish a rate governing the sale of * * * energy" (16 U.S.C. 824e(d)) in those interstate settings, even when the transmission service is unbundled from the retail sale of energy. Although the Commission would regulate rates for transmission service, the State would regulate the sale of energy, and, in connection with that state regulation, the Commission could provide information pursuant to Section 206(d) regarding production or transmission costs that are outside the State's jurisdiction. See 1 J.A. 354-355, 425-430.

New York further argues (N.Y. Pet. Br. 33-34, 36) that Section 212(h) of the FPA, 16 U.S.C. 824k(h), forecloses Commission jurisdiction over unbundled retail transmission services in interstate commerce. As the plain language of Section 212(h) states, and as the Commission explained in Order No. 888, that provision "prohibit[s the Commission] from *ordering* transmission directly to an ultimate consumer." 2 J.A. 596 (emphasis in original); see note 11, *supra*. The Commission respected that limitation by ordering public utilities to provide "functional unbundling" of transmission services only in the context of wholesale transactions. See 1 J.A. 106, 350. A public utility is not required to file a federal

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[17] See H.R. Rep. No. 1318, 74th Cong., 1st Sess. 29 (1935) ("This subsection reaches those situations where electric energy is transmitted in interstate commerce by the same company which distributes it locally, and will greatly aid State commissions in fixing reasonable rates in such cases.").

tariff for unbundled interstate transmission in connection with retail sales unless the utility offers that transmission service voluntarily or state regulators—not federal regulators—allow retail competition by mandating the provision of such a transmission service. See 2 J.A. 695 (pro forma tariff § 1.11, limiting retail customers' eligibility for tariffed transmission service to customers served voluntarily or as part of a state retail access program).

2. The Act's legislative history, on which New York principally relies, is equally inconsistent with New York's theory of the case. The Senate Report on the Act states that Congress assigned the FPC jurisdiction over interstate transmission even "where there is no sale" of the energy being delivered. That statement confirms that the Commission's transmission jurisdiction is not limited to transmission accompanied by a wholesale sale of electric energy. S. Rep. No. 621, *supra*, Pt. 1, at 19; see also *id.* at 48 ("Jurisdiction is asserted also over all interstate transmission lines whether or not there is sale of the energy carried by those lines").[18] Other legislative history is to the same effect. See Enron Pet. Br. 23-24.

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[18] When Congress drafted the FPA, there already was a history of utilities providing transmission service for other utilities, without buying or selling the energy being transmitted. For example, in the *Attleboro* case, to which Congress responded when drafting the FPA, Seekonk Electric Company in Massachusetts received power generated in Rhode Island by Narragansett Electric Lighting Company, and carried that power over Seekonk's transmission lines to Attleboro Steam & Electric Company (also in Massachusetts), which had purchased the power from Narragansett. See *Attleboro Steam & Elec. Co.* v. *Public Utils. Comm'n*, 129 A. 495, 496 (R.I. 1925), aff'd, 273 U.S. 83 (1927).

California suggests that when the Senate committee said that Section 201 of the FPA gives the FPC jurisdiction over interstate transmission when there is no sale of energy, it actually meant that Section 206(d) allowed the FPC to provide accounting information to support the States' exercise of *their* jurisdiction in situations where there is a sale at retail but not at wholesale. Cal. Br. 17 & n.9. Even California seems not to take that

More generally, Congress intended to ensure that the FPC would be able to oversee those services and facilities that state regulators could not lawfully, or effectively, regulate. Congress's overriding concern was that there never be a jurisdictional void. See *Louisiana Power & Light*, 406 U.S. at 640-641; *Arkansas Elec. Coop.*, 461 U.S. at 384 ("Congress' purpose in 1935 was to fill a regulatory gap, not to perpetuate one."); S. Rep. No. 621, *supra*, Pt. 1, at 48.

New York's narrow reading of Section 201 would defeat that paramount legislative intent. If the State in which the retail customer is located has jurisdiction to regulate all unbundled transmission associated with a retail sale, there would be a large regulatory gap when the retail customer purchases power from a supplier in a distant State, and that supplier requires transmission service from intervening out-of-state utilities to deliver the power. See 1 J.A. 427. The intervening transmission would be beyond the jurisdictional reach of the consumer's State. Thus, under New York's theory, those out-of-state transmission services would not be subject to meaningful regulation.

The most important fact about New York's reliance on legislative history, however, is that New York is unable to identify any statement indicating an actual congressional intent that if interstate transmission were separated from the associated retail sale of energy, the unbundled transmission would be subject to exclusive state regulation. There is no such evidence, because "the legislative history of the FPA * * * grew out of a market structure in which electricity and transmission generally were bought and sold

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strained reading of the Senate Report seriously, for it offers (*id.* at 17-18 n.10) two alternative theories. Like California's principal theory, however, both of the alternative theories implausibly assume that the Senate Report's discussion of federal transmission jurisdiction under Section 201(b) actually addressed the FPC's powers under entirely different, and unidentified, provisions of the Senate bill.

on a bundled basis." 1 J.A. 347. Accordingly, when legislators stressed that federal regulators would not "fix the rate of delivery" of electric power (see N.Y. Pet. Br. 24), and when the FPC noted that it lacked "authority over local rates" (see *id.* at 25-26), they were saying nothing more than what the Commission said in Order 888: Under the FPA, the States "clearly retain[] jurisdiction over" retail sales of power. 1 J.A. 350.[19]

3. New York admits (N.Y. Pet. Br. 12) that in 1935 Congress did not envision unbundling of retail transmission from retail sales of energy. But New York attempts to turn that fact to its advantage by arguing (*id.* at 13-17) that, as a matter of "preemption" law, the court of appeals in these cases erred by upholding the Commission's jurisdictional ruling absent "clear and manifest" Congressional intent regarding unbundled transmission. New York is mistaken on several counts.

First, New York's premise—that the Commission is seeking to seize jurisdiction over a service that the States traditionally have regulated (N.Y. Pet. Br. 14-15)—misstates the situation. Given that unbundled transmission in connection with retail sales is a new service, the Commission's task was not to decide whether historical state jurisdiction should

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[19] Likewise, New York is mistaken when it says (N.Y. Pet. Br. 17) that the Commission has changed its interpretation of Section 201. The statements cited by New York (*id.* at 21-22, 25-26, 31 & n.14, 41, 42 n.26) simply, and consistently, acknowledge the States' jurisdiction over bundled retail sales and local distribution. They do not address jurisdiction over unbundled retail transmission in interstate commerce. In his Senate testimony, for example, FPC Solicitor DeVane distinguished the interstate wholesale sales that would be regulated by the FPC from "energy that is transmitted in interstate commerce by a particular company and sold by that company to consumers," which the States would continue to regulate. Mr. DeVane did not address any other potential retail arrangements. *Public Utilities Holding Co. Act of 1935: Hearings on S. 1725 Before the Senate Comm. on Interstate Commerce*, 74th Cong., 1st Sess., Pt. 2, at 250 (1935).

be "preempted," but to determine whether the new service comes within the States' unquestioned jurisdiction over bundled retail sales, or, rather, the Commission's clearly established jurisdiction over transmission in interstate commerce. See 2 J.A. 593-595; see generally *West* v. *Gibson*, 527 U.S. 212, 218 (1999) ("Words in statutes can enlarge or contract their scope as other changes, in law or in the world, require their application to new instances").

Second, the court of appeals' affirmance did not depend upon "the deferential standard of *Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984)." N.Y. Pet. Br. 17 n.8.; see *id.* at 16. As the court of appeals stated, its primary holding was that the "clear[] and unambiguous[]" language of Section 201, as well as this Court's decisions in *Jersey Central* and *Florida Power*, compel the conclusion "that the FPA gives [the Commission] the authority to regulate transmissions at issue here, whether retail or wholesale." 1 Pet. App. 32a, 34a. *Chevron* deference was an alternative basis for upholding the Commission's jurisdiction. See *id.* at 34a-35a.[20]

Third, New York ignores *stare decisis* principles. Cases such as *Jersey Central*, *Connecticut Light & Power*, and *Florida Power* provide "cardinal and guiding" interpreta-

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[20] *Solid Waste Agency* v. *United States Army Corps of Engineers*, 121 S. Ct. 675 (2001), has no relevance even with respect to the court of appeals' alternative holding. See N.Y. Pet. Br. 16. In *Solid Waste Agency*, the Court declined to give *Chevron* deference to an agency interpretation that "push[ed] the limit of congressional authority" and therefore raised "significant constitutional questions." 121 S. Ct. at 683. In this case, the Court has already decided as a matter of constitutional law that "generation, transmission, distribution and consumption are so fused and interdependent that the whole enterprise is within the reach of the commerce power" if the utility connects to an interstate grid. *Connecticut Light & Power*, 324 U.S. at 529-530. The issue is whether, as a statutory matter, Congress chose to exercise its power to regulate unbundled retail transmission.

tions of Section 201 (*California* v. *FERC*, 495 U.S. 490, 497-499 (1990)), upon which the Commission properly relied. See *Maislin Indus., Inc.* v. *Primary Steel, Inc.*, 497 U.S. 116, 131 (1990) ("Once we have determined a statute's clear meaning, we adhere to that determination under the doctrine of *stare decisis*, and we judge an agency's later interpretation of the statute against our prior determination of the statute's meaning.").

Fourth, New York disregards the presumption *in favor* of federal jurisdiction under Section 201, where such jurisdiction is necessary to fill a possible jurisdictional void. As noted above, "Congress desired regulation by federal authority rather than non-regulation." *Louisiana Power & Light*, 406 U.S. at 641 (citation and internal quotation marks omitted). Therefore, as this Court has held, the enumerated exceptions to federal jurisdiction stated in Section 201 "are to be strictly construed." *California PUC*, 345 U.S. at 310. New York's proposed approach of forbidding federal regulation unless there is affirmative evidence of congressional intent that the statutory exceptions will *not* apply, risks creating the very jurisdictional vacuum that Congress wanted to avoid.

In other cases that presented questions of federal jurisdiction under Part II of the FPA—such as *Jersey Central*, *Connecticut Light & Power*, and *Florida Power*—this Court has straightforwardly "construe[d] § 201(b) as it is written, and as its legislative history indicates it was intended," without applying the anti-federal gloss suggested by New York. *New England Power*, 455 U.S. at 343; see *Arkansas Elec. Coop.*, 461 U.S. at 379 (Part II of FPA "shifted this Court's main focus—in determining the permissible scope of state regulation of utilities—from the constitutional issues * * * to analyses of legislative intent."). The Court has taken the same approach when applying analogous jurisdictional provisions. See *Louisiana Pub. Serv. Comm'n* v. *FCC*, 476 U.S. 355, 359, 376-377 n.5

(1986) (treating resolution of conflict between federal and state telecommunications regulation as an ordinary matter of statutory interpretation). Contrary to New York's thesis, nothing in this Court's decisions suggests that the Commission or the court of appeals should have applied a presumption against federal jurisdiction.

D. Policy Considerations Also Do Not Support New York's Interpretation

Finally, New York argues (N.Y. Pet. Br. 46-48) that Order No. 888 will undermine the States' ability to ensure that consumers receive reliable retail electric service at just and reasonable rates. California similarly maintains (Br. 27-30) that the Commission lacks statutory authority to regulate unbundled retail transmission adequately, and that the Commission has made the wrong policy choices in the past.

Those policy arguments are "properly addressed to Congress, not to the Courts." *Chemehuevi Tribe of Indians* v. *FPC*, 420 U.S. 395, 423 (1975).[21] Furthermore, New York offers nothing to support its assertion that the Commission's regulation of unbundled retail transmission will hamper regulation of facilities and services within the States' jurisdiction. The Commission specifically clarified that, even if a State chooses to order retail unbundling, it retains authority under Order No. 888 over local matters such as power production, customer service, and local service reliability, in addition to its authority over rates for retail sales of energy. 1 J.A. 351-355. The Commission also committed—when exercising its jurisdiction over unbundled transmission in interstate commerce in connection with retail sales—to

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[21] New York's invocation of *Chemehuevi Tribe* (N.Y. Pet. Br. 15) is wholly misplaced. In that case, the Court rejected an argument that statutory language should be disregarded when the policy choice underlying that language is outmoded. 420 U.S. at 422-424. Here, by contrast, the Commission applied the plain language of Section 201 to new circumstances.

cooperate with state regulators on various matters that implicate their expertise and concerns and to afford deference to the views of the States when applying its test for identifying local distribution facilities. 1 J.A. 355-360. Finally, while transmission assets may be shifted from state to federal jurisdiction as a result of retail unbundling, the resulting accounting issues would be "commonplace." *FPC* v. *Conway Corp.*, 426 U.S. 271, 280 & nn. 6, 7 (1976).

Nor is there merit to California's argument (Br. 28-29) that the Commission lacks the authority it needs to ensure adequate and nondiscriminatory transmission service. Order No. 888 requires public utilities to provide their unbundled transmission services to all eligible customers under the same terms and conditions that apply to the utility's own operations. See 2 J.A. 440-443 (18 C.F.R. 35.28(c), requiring public utilities to file open-access transmission tariffs and to obtain transmission service under those generally available tariffs). The Commission's pro forma tariff also obligates the public utility to take appropriate steps to provide sufficient transmission capacity to serve all tariff customers on a nondiscriminatory basis. 2 J.A. 729, 767-770 (tariff §§ 15.4, 32).

New York argues (N.Y. Pet. Br. 48) that Order No. 888 will deter States from requiring unbundling of transmission from retail sales, because unbundling would trigger federal jurisdiction and "diminish[]" the States' own jurisdiction over transmission. That contention assumes that States regulate to maximize their own jurisdiction, rather than to promote the public interest—a proposition New York itself rejects as respondent in No. 00-809. See N.Y. Resp. Br. 18-23. Indeed, numerous States have adopted "retail choice" programs since the Commission issued Order No. 888.[22]

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[22] Before Order No. 888, 12 States had acted to give retail customers a choice of power suppliers. 1 J.A. 95 & n.101. As of May 2001, 25 States had adopted such programs by legislation or administrative order. See

California suggests (Br. 1) that the jurisdictional lines identified in Order No. 888 have contributed to that State's current energy crisis. Enron disagrees. Enron Resp. Br. 16 n.6. The Commission has found that the principal causes of California's electricity crisis were state regulations that required all utilities to purchase their wholesale requirements through a spot market exchange, froze retail rates at levels lower than wholesale rates, and inhibited construction of new electric generating capacity. *San Diego Gas & Elec. Co.* v. *Sellers of Energy and Ancillary Servs. into Mkts. Operated by the Cal. Indep. Sys. Operator and the Cal. Power Exch.*, 93 F.E.R.C. ¶ 61,121, at 61,351, 61,353, 61,360 (2000), mandamus denied, 245 F.3d 1110 (9th Cir. 2001). Those causal factors have nothing to do with regulation of unbundled transmission. Order No. 888 likewise does not implicate the disagreement regarding state control over the governing board of the California Independent System Operator, to which California refers (Br. 27-28). That disagreement, moreover, has been resolved. See *Western Power Trading Forum* v. *FERC*, 245 F.3d 798, 799-800 (D.C. Cir. 2001).

II. THE COMMISSION REASONABLY CONCLUDED THAT CONGRESS HAS NOT AUTHORIZED FEDERAL REGULATION OF THE TRANSMISSION COMPONENT OF BUNDLED RETAIL SALES OF ELECTRIC ENERGY

In No. 00-809, petitioner Enron, which supports the Commission's determination that the FPA establishes federal jurisdiction over *unbundled* transmission for retail sales, argues that the court of appeals erred by deferring to the Commission's further conclusion (1 J.A. 349-350) that it lacks jurisdiction to regulate the transmission provided by

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Energy Information Administration, U.S. Dep't of Energy, *Status of State Electric Industry Restructuring Activity as of May 2001* (available at <http://www.eia.doe.gov/cneaf/electricity/chg_str/regmap.html>).

public utilities in their *bundled* retail sales. See 1-Pet. App. 35a. Enron contends (Enron Pet. Br. 21) that "Section 201(b) * * * explicitly gives [the Commission] jurisdiction, without any stated limitation or qualification, over all interstate transmissions * * * for both wholesale and retail sales," and that the Commission disregarded that "plain meaning" by "read[ing] into section 201(b) an exception for transmissions that are bundled at retail." Enron further suggests (*id.* at 41-43) that applying the Commission's pro forma open-access tariff to transmission that is bundled with a retail sale of energy is necessary to prevent public utilities from providing inferior transmission to transmission customers who do not also buy energy from the utility at retail.

Enron's understanding of the Commission's transmission jurisdiction is correct—as far as it goes. As the court of appeals held (1 Pet. App. 32a-34a), and as we have demonstrated in Part I, above, Section 201(b) assigns the Commission jurisdiction over interstate transmission whether it is used in conjunction with a wholesale sale of energy or a retail sale of energy. But Section 201(b)(1) also assigns the States jurisdiction over "any * * * sale of electric energy" that is not "at wholesale in interstate commerce." 16 U.S.C. 824(b)(1). The issue faced by the Commission, therefore, was whether a public utility's sale at retail of delivered energy in a single transaction—in a State that does not permit consumers to choose their power supplier—constitutes (1) a retail sale of energy within the States' jurisdiction, or (2) a state-regulated retail sale of energy *as well as* a federally regulated transmission service. See 1 J.A. 349-350.

The court of appeals correctly concluded (1 Pet. App. 34a) that "Congress has not directly addressed th[at] precise question" with unambiguous language. *Chevron U.S.A. Inc.* v. *Natural Res. Def. Council*, 467 U.S. 837, 843 (1984). Nothing in Section 201(b) establishes the proper characterization of a bundled transaction. Whereas Section 201(b) clearly gives the Commission jurisdiction over transmission,

and clearly gives the States jurisdiction over non-wholesale sales of energy, "[t]he statute is much less clear about exactly where the lines between those activities are to be drawn." 1 Pet. App. 35a.

Section 201(a) does not resolve the ambiguity. While federal jurisdiction "extend[s] only to those matters which are not subject to regulation by the States," 16 U.S.C. 824(a), that declaration of policy is, as this Court has held, itself ambiguous. *California PUC*, 345 U.S. at 308-309.

The legislative history of the FPA is inconclusive as well. Enron cites legislative history suggesting that the Act would give the Commission jurisdiction over interstate transmission "[w]hether it be wholesale or retail." Enron Pet. Br. 23 (quoting House hearings) (emphasis omitted); see *id.* at 23-24 (discussing legislative history). Other legislative history, however, reflects an intent to "tak[e] no authority from State commissions" and to maintain "valid state authority" that was then being exercised. *New England Power*, 455 U.S. at 341 & n.7 (emphasis omitted). In particular, the committee reports state that "the authority of States to fix local rates"—which then referred to bundled rates for delivered power, including the transmission component, see 2 J.A. 593-594—"[wa]s not disturbed." H.R. Rep. No. 1318, *supra*, 27; accord S. Rep. No. 621, *supra*, Pt. 1, at 48. Unlike the Commission's exercise of jurisdiction over the new service of unbundled retail transmission, the exercise of federal jurisdiction over the transmission component of traditional bundled retail service would affect historical state regulation and local rates.

Louisiana Power & Light also was not "controlling" (Enron Pet. Br. 22) on the record before the Commission in the Order No. 888 proceeding. The Court held in *Louisiana Power & Light* that the Commission had authority to direct interstate natural gas pipelines to curtail deliveries to all customers in time of shortage, and that such curtailment regulations did not interfere with the States' exclusive

authority over retail sales of gas. 406 U.S. at 623-647. The critical considerations under the Natural Gas Act were that curtailment rules did not implicate local rate-setting, *id.* at 637-638, and that leaving allocation of scarce gas to the States would "create contradictory regulations that cannot possibly be equitably resolved by the courts," *id.* at 634. Because the federal curtailment requirements addressed transportation rather than retail sales, *id.* at 638-640, and because state rationing of interstate gas was not feasible, *id.* at 641, the curtailment requirements were permissible.

Neither of those considerations was present on the record before the Commission in the Order No. 888 proceeding. Enron acknowledges (Enron Pet. Br. 26) that federal regulation of the transmission component of a bundled sale potentially implicates retail rate-setting. Furthermore, the record before the Commission did not establish that the current arrangement, under which the transmission component of bundled sales is subject to regulation as part of the regulation of retail sales, is unworkable. Cf. 1 J.A. 227 (finding that federal unbundling of retail transactions is not necessary to prevent discrimination), 2 Pet. App. 453a-454a (noting same).

Enron has never provided clear record support—in a rehearing petition before the Commission, in the court of appeals, or in this Court—for its argument (which the court of appeals did not address, see 1 Pet. App. 35a) that federal action with respect to the transmission component of a bundled retail sale is necessary to fill a gap created by practical limitations on state regulation. Nor has Enron shown that its proposal for a categorical extension of the open-access tariff requirement to bundled retail sales is necessary to ensure just, reasonable, and nondiscriminatory terms for services that *are* currently regulated by the Commission.[23]

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[23] The Commission has concluded a rulemaking regarding Regional Transmission Organizations (RTOs) that addresses some of Enron's

Citing *Northern States Power Co.* v. *FERC*, 176 F.3d 1090 (8th Cir. 1999), cert. denied, 528 U.S. 1182 (2000), Enron suggests (Enron Pet. Br. 24-25 n.17, 42 & n.27) that, absent application of the open-access tariff to bundled retail transmission, public utilities facing a need to curtail their transmission will favor their own bundled retail service and disadvantage customers of unbundled transmission obtained under Order No. 888's open-access rules. In *Northern States Power*, the Commission had rejected proposed curtailment provisions of a public utility's federal open-access transmission tariff that favored the utility's retail customers over wholesale transmission customers who are unquestionably subject to the Commission's jurisdiction. The Eighth Circuit held that the Commission exceeded its authority under the Act. 176 F.3d at 1093-1096. While the Commission continues to believe that it has authority to require public utilities to treat customers of unbundled interstate transmission in a manner that is comparable to the treatment afforded bundled transmission users, and thereby to prevent discrimination against users of federally regulated services, the Commission has also concluded that even under the court of appeals' decision, it is not powerless to address such discrimination.[24]

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concerns. Order No. 2000, *Regional Transmission Orgs.*, 65 Fed. Reg. 809, on reh'g, Order No. 2000-A, 65 Fed. Reg. 12,088 (2000), appeal pending *sub nom. Public Utils. Dist. No. 1* v. *FERC*, No. 00-1174 (D.C. Cir. to be argued Oct. 17, 2001). An RTO serves as the sole transmission provider within its region, providing all transmission for wholesale power transactions as well as bundled and unbundled retail power transactions. The Commission has provisionally approved three RTOs, and additional applications are pending. Also, Enron could in the future petition the Commission to revisit its resolution of the jurisdictional ambiguity in the FPA on the basis of changed industry conditions. See *Chevron*, 467 U.S. at 863-864.

[24] On remand from the court of appeals, the Commission recognized that a utility could depart from pro-rata transmission curtailment in the "rare circumstance[]" when the utility has exhausted all of its options for

In light of the equivocal language and history of the FPA and the limited record before the Commission, the court of appeals properly deferred to the Commission's reasonable decision not to override the States' historical regulation of transmission that is bundled with a retail sale of energy. See generally *Chevron*, 467 U.S. at 842-845.[25] The Commission's jurisdictional determination, in turn, resolves Enron's final argument (Enron Pet. Br. 33-44) that Section 206 of the FPA, 16 U.S.C. 824e, requires the Commission to exercise jurisdiction over the transmission involved in public utilities' retail operations, even if the relevant State favors traditional bundled sales. Section 206 authorizes the Commission to remedy undue discrimination with respect to matters subject to its jurisdiction. See 16 U.S.C. 824e(a). In light of the Commission's reasonable finding that it lacks jurisdiction over the transmission component of bundled retail sales

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avoiding transmission curtailment, and has established that the transmission customers that would be disproportionately affected by the curtailment have options to reduce their need for transmission capacity. The Commission, however, required the utility to adopt specific tariff provisions for ensuring that all options for avoiding curtailment are first exhausted, and for affording those customers who would carry an extra burden either alternative supply options or compensation, as well as reduced rates for the inferior quality of service they are provided. *Northern States Power Co. (Minn.)*, 89 F.E.R.C. ¶ 61,178, at 61,553 (1999).

[25] Enron relies on the supposedly "plain language of the statute" (Enron Pet. Br. 20; see *id.* at 43), and does not dispute that, if the statute and its legislative history are ambiguous, the Commission has provided a "reasonable interpretation" (*Chevron*, 467 U.S. at 844) of the FPA. Likewise, Enron does not challenge the court of appeals' holding (1 Pet. App. 34a-35a) that an agency's interpretation of a statutory provision that defines the scope of the agency's jurisdiction is entitled to *Chevron* deference. This Court has applied the same rule. See *CFTC* v. *Schor*, 478 U.S. 833, 844-845 (1986); *NLRB* v. *City Disposal Sys., Inc.*, 465 U.S. 822, 830 n.7 (1984); see also *Mississippi Power & Light Co.* v. *Mississippi*, 487 U.S. 354, 380-382 (1988) (Scalia, J., concurring in the judgment); *Dole* v. *United Steelworkers*, 494 U.S. 26, 54-55 (1990) (White, J., dissenting).

under Section 201, the Commission was not required to regulate that transmission component under Section 206.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

BARBARA D. UNDERWOOD
Acting Solicitor General

EDWIN S. KNEEDLER
Deputy Solicitor General

AUSTIN C. SCHLICK
Assistant to the Solicitor General

KEVIN P. MADDEN
General Counsel

CYNTHIA A. MARLETTE
Deputy General Counsel

SUSAN J. COURT
Associate Solicitor

TIMM L. ABENDROTH
DAVID H. COFFMAN
Attorneys
Federal Energy Regulatory Commission

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PEOPLE OF THE STATE OF NEW YORK AND THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

ENRON POWER MARKETING, INC.,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

REPLY BRIEF OF ENRON POWER MARKETING, INC. AS PETITIONER IN NO. 00-809

JEFFREY D. WATKISS
BRACEWELL & PATTERSON, L.L.P.
2000 K Street, N.W.
Suite 500
Washington, D.C. 20006
(202) 828-5800

JOSEPH R. HARTSOE
SARAH NOVOSEL
ENRON CORPORATION
1775 I Street, N.W.
Washington, D.C. 20006
(202) 828-3360

LOUIS R. COHEN
Counsel of Record
JOSEPH E. KILLORY, JR.
JONATHAN J. FRANKEL
IJAY PALANSKY
MICHAEL PLOTNICK
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, D.C. 20037-1420
(202) 663-6000

Counsel for Petitioner Enron Power Marketing, Inc.

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INTRODUCTION AND SUMMARY

In Orders No. 888 and 888-A, FERC found that the public utilities that own interstate transmission facilities discriminate, with respect to terms of access and usage, against other suppliers of electricity and in favor of their own transmissions. *See, e.g.*, NOPR at 33,052, Pet App. 566a; Order No. 888 at 31,682, 31,919-26, Pet. App. 214a, 315a-331a; Order No. 888-A at 30,210, Pet. App. 435a; (FERC Br. at 11). Pursuant to its statutory mandate to eliminate undue discrimination, 16 U.S.C. § 824e(a), FERC ordered such utilities to end discrimination between (a) the transmission they provide to competing suppliers and (b) the transmission they provide to themselves for their own (i) wholesale sales and (ii) *un*bundled retail sales. But although FERC concluded that it would be "helpful" also to require such utilities to take transmission service for their *bundled* retail sales on the same nondiscriminatory terms, Order No. 888 at 31,699, Pet. App. 235a, it read the Federal Power Act (FPA) as denying it jurisdiction to do so. It therefore allowed the utilities to continue to discriminate in favor of their own transmissions that account for about 60% of the pertinent usage of the interstate grids. (*See* Enron Pet. Br. at 5.)

The D.C. Circuit upheld FERC's abdication of jurisdiction over transmissions to serve bundled retail sales on the ground that the FPA is ambiguous and therefore the agency is entitled to deference under *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). In this Court, FERC urges affirmance primarily on that ground. Respondents New York et al. (New York) and Edison Electric Institute (EEI), the trade association of transmission-owning utilities, argue in addition that FERC jurisdiction over such transmissions would interfere with the traditional authority of the states over retail sales. EEI argues further that in any event there is no discrimination because, it alleges, there is no competition to serve bundled retail customers. All of these arguments are wrong.

Preliminarily, four important points are not open to serious dispute. First, "transmission" of electric energy at high voltage over a grid is distinct, as both a physical matter and a statutory matter, from "distribution" at low voltage over radial electric lines. (*See* Enron Resp. Br. in No. 00-568, at 28-32; FERC Br. at 30-34; Transmission Access Policy Study Group (TAPS) Br. at 21-24; Electrical Engineers et al. (Experts) Br. at 26.) Second, transmission is exactly the same, and uses the grid in the same way, regardless of whether the transmitted energy is sold on a bundled or unbundled basis. (*See* Enron Pet. Br. at 4-5, 30-31; Experts Br. at 2, 8-11, 14-17.) Third, section 201 of the FPA, 16 U.S.C. § 824(b), gives FERC "jurisdiction over public utilities' transmission of energy in interstate commerce 'without qualification.'" (FERC Br. at 13; *see also* Enron Pet. Br. at 21-27.) Fourth, except for some transmissions within Texas, virtually all electric transmission within the contiguous United States is "in interstate commerce" because (a) every transmission over an electric grid uses the entire grid (*see* FERC Br. at 27; TAPS Br. at 27-30; Experts Br. at 2-3, 10-11, 16-17), and (b) today (although this was not true in 1935) all non-Texas transmission lines are interconnected. (*See* Enron Pet. Br. at 9, 28; FERC Br. at 4-5, 25-27; Experts Br. at 2-3, 19, 30.)

FERC's argument that there is an "ambiguity" with respect to FERC's jurisdiction is not based on the language of section 201(b)(1) regarding transmission. FERC concedes that this provision would, standing alone, grant jurisdiction over all transmission in interstate commerce. (*See* FERC Br. at 28-29, 45.) FERC contends that ambiguity is created by the Act's separate confirmation of state jurisdiction over retail *sales* of electric energy. New York and EEI go further, arguing that FERC jurisdiction over interstate transmission, if construed to reach transmissions that serve bundled retail sales, would interfere with authority Congress left to the states.

There is no ambiguity and no interference, as this Court has already held in interpreting the parallel provisions of the

Natural Gas Act. *See FPC v. Louisiana Power & Light Co.*, 406 U.S. 621, 637-38 (1972) (*LP&L*). Interstate transmission, like interstate transportation of natural gas, is *both* a federally regulated activity *and* a component of bundled retail service whose cost is factored into state-regulated retail rates. Federal regulation of such transmission is perfectly compatible with plenary state regulation of retail sales, just like federal regulation of railroad charges for carrying coal to a utility's generators or federal regulation of the communications charges the utility incurs in doing business. The rights of the states to decide who may serve their retail customers and to dictate the terms and quality of that service are not challenged by anyone and not at issue.

This case is not, however, solely or primarily about the price charged for transmission: it is about fair and nondiscriminatory access to and usage of the interstate grids,[1] based on a published tariff that sets forth rules of access, procedures for scheduling and information sharing, rules for curtailment in periods of system constraint, and similar matters. (*See* TAPS Br. at 31-38 (describing the "inherent[ ] unworkab[ility]" of state regulation, and necessity for federal regulation, of the interstate grids).) Respondents argue that because bundled retail customers normally have no choice of supplier, there is no competition, hence no discrimination,

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[1] As amicus Pennsylvania Public Utility Commission points out (Br. at 7):

> New York[ ] . . . erroneously conflates State ratemaking powers with rules controlling the operation of the interstate transmission network. Transmission rates are actually a relatively small component of retail electric rates. It is clear from New York's argument (and even more so from the novel theory advanced by California . . .) that retail rates are not the issue here. Network control and 'rules of the road' are what is being fought over. Who controls the interstate grid gets to decide a great many things, including wholesale generation market design and which wholesale electricity transactions will flow and which will be cut or reduced.

and hence no need for any regulation of interstate transmission other than whatever review of transmission costs a state chooses to conduct in connection with retail ratemaking. But all transmission competes for access to the interstate grids, whether the ultimate retail sale is unbundled or bundled and, as FERC has recognized, a transmission owner unduly discriminates when it treats other transmission users less favorably than it treats itself, whether or not they are competing for the same energy customer. *See American Elec. Power Serv. Corp.*, 64 F.E.R.C. ¶ 61,279 (1993). Moreover, utilities that serve bundled retail customers do compete with other suppliers for various important classes of customers (e.g., municipalities, cooperatives, large industrial customers) and their ability to provide themselves with superior transmission stifles that competition.

FERC's decision to abdicate its jurisdiction over transmissions whose cost is bundled with retail sales of energy leaves a regulatory vacuum that all but invites interstate conflict. Users in every contiguous state depend on the interstate transmission grids, including the portions that lie in other states, to receive electricity from close and distant generators. Current events vividly demonstrate that capacity on those grids is often short. The open access regime was intended as a uniform set of rules for allocating that capacity fairly. But as some states (*see* PA Br. at 3-4, 15) have recognized, FERC, by disclaiming jurisdiction, has permitted a state to circumvent true open access, and beggar its neighbors, by asserting a superior claim to the in-state portion of the interstate grid capacity for *its* bundled retail customers, making that capacity unavailable for other states' through transmissions. One court of appeals has explicitly allowed this to happen. *See Northern States Power Co. v. FERC*, 176 F.3d 1090 (8th Cir. 1999), *cert. denied*, 528 U.S. 1182 (2000). No state can protect itself from its neighbors' selfish use of "their" parts of the grid, because no state has jurisdiction to regulate the out-of-state portions of interstate lines. FERC's

abdication threatens the nationwide markets for power that Congress sought to build.

ARGUMENT

I. THE FEDERAL POWER ACT GRANTS FERC JURISDICTION OVER ALL TRANSMISSION OF ELECTRIC ENERGY IN INTERSTATE COMMERCE, INCLUDING TRANSMISSIONS WHOSE COST IS BUNDLED INTO A RETAIL SALES CHARGE.

A. The FPA Is Not Ambiguous with Respect to FERC's Jurisdiction over Interstate Transmission.

The D.C. Circuit ruled, and FERC argues in this Court, that the FPA is ambiguous and that FERC's determination that it lacked jurisdiction over transmissions bundled with retail sales is therefore entitled to deference. But the relevant provision of the FPA is not ambiguous, and the agency and courts are bound by what it plainly says. *See Chevron*, 467 U.S. at 842-43.

Section 201(b) gives FERC jurisdiction over "the transmission of electric energy in interstate commerce . . . ." 16 U.S.C. § 824(b). As FERC recognizes (*see* Br. at 45), there is no stated qualification or limitation based on the terms of the ensuing sale or on anything else. *Cf. LP&L*, 406 U.S. at 637-38 (finding no limitation in the parallel NGA provision). Instead, FERC argues that an ambiguity is created, leaving room for FERC interpretation, because "[s]ection 201(b) also assigns the states jurisdiction over 'any . . . sale of electric energy' that is not 'at wholesale in interstate commerce.'" (Br. at 45.)

But there is no conflict between the two parts of section 201(b), and there is no ambiguity for FERC to resolve. The terms of transmission in interstate commerce, including all aspects of access to and usage of the interstate grids, are explicitly subject to FERC jurisdiction. The cost of transmis-

sion is one of a number of component costs incurred by a retail utility that are clearly subject to federal regulation (including the cost of power purchased at wholesale). Such federal regulation does not usurp any state regulatory power, including the states' right to regulate the retail price of electricity. It simply means that if a state regulator chooses to use cost-based rate-setting, then it must take a utility's federally determined costs into account in setting a final price. *Cf. Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 966 (1986).

EEI asserts that, in the case of bundled retail sales, interstate transmission becomes an "inseparable" part of the retail "sale of electric energy." (Br. at 38.) But transmission and the sale of energy are no more "inseparable" (in the sense of being impossible to regulate separately) than the (federally regulated) cost of transporting a good to market and the (state regulated) act of selling it. Bundling does not turn the transmission into a sale, and transmission uses the grids the same way, regardless of how its cost is reflected on the end user's power bill. The very word "bundling" implies that different things—here generation, transmission, and delivery—are wrapped together for purposes of sale.[2]

EEI adds (*see id.* at 38) that since section 201(b) unambiguously gives FERC jurisdiction over wholesale sales in interstate commerce, the additional language confirming state jurisdiction over "any other sale of electric energy" must be interpreted to mean "the *transmission* of energy for retail sale," because otherwise the "any other sale" language would be superfluous. As it happens, this Court has already rejected

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[2] EEI contradicts its own argument by conceding that, even when transmission is bundled with the retail sale of energy, FERC retains jurisdiction to review the utility's "'set aside' for bundled retail service (i.e., for 'native load'), to ensure that utilities do not arbitrarily withhold transmission capacity from the open access market." (Br. at 48; *see also* NY Br. at 18 (conceding that FERC has jurisdiction to "limit[ ] the ability of a utility to reserve transmission capacity for native load to levels needed to accommodate reasonable growth") (citations omitted).)

this remarkable argument. Interpreting the parallel language in the NGA, the Court determined that Congress was simply adding belt to suspenders:

> It is well established that the proviso [to section 1(b) of the Natural Gas Act, denying the FPC jurisdiction over "any other . . . sale of natural gas"] was added to the Act merely for clarification and was not intended to deprive FPC of any jurisdiction otherwise granted by § 1(b). The House report on the bill described this second sentence of § 1(b) as follows: "The quoted words are not actually necessary, as the matters specified therein could not be said fairly to be covered by the language affirmatively stating the jurisdiction of the Commission, but similar language was in previous bills, and, rather than invite the contention, however unfounded, that the elimination of the negative language would broaden the scope of the act, the committee has included it in this bill."

LP&L, 406 U.S. at 637-38 n.14 (quoting H.R. Rep. No. 75-709, at 3 (1937)).

FERC argues (*see* Br. at 46) that the "legislative history of the FPA is inconclusive," but legislative history—in particular "inconclusive" legislative history—cannot make a clear statute ambiguous. *See Ratzlaf v. United States*, 510 U.S. 135, 147-48 (1994). Moreover, the legislative history that FERC, New York, and EEI cite does not suggest any ambiguity. All three respondents point to language preserving "the authority of States to fix local rates." (FERC Br. at 46; NY Br. at 8; EEI Br. at 39 n.30.) But this state authority does not obscure FERC's authority to regulate interstate transmission any more than it obscures FERC's authority to regulate wholesale sales. As Enron showed in its opening brief (Br. at 23-25), the legislative history of the FPA in fact supports FERC jurisdiction over all interstate transmission, wholesale or retail, bundled or unbundled. FERC's and New York's unsuccessful attempts to answer this showing (*see*

FERC Br. at 46; NY Br. at 7-12) misread statements in the legislative history about retail sales as if they were discussing transmission and, in the case of New York, confuse transmission with distribution (*see* NY Br. at 11).

Finally, contrary to respondents' arguments, this Court's decision in *LP&L* is directly on point. At issue in *LP&L* was FERC's jurisdiction to include bundled retail sales of natural gas in FPC-ordered curtailment plans during periods of short supply. The Court held that section 1(b) of the Natural Gas Act (NGA), 15 U.S.C. § 717(b), which parallels and is nearly identical to section 201(b) of the FPA, granted FERC jurisdiction over the transportation of natural gas, even when transportation was bundled with a retail sale. 406 U.S. at 636-37.

FERC acknowledges that *LP&L* "confirms that the Commission's jurisdiction over interstate transmission is in addition to, and is not limited by, its jurisdiction over wholesale sales." (Br. at 19-20; *see also id.* at 28-29.) But FERC later, inconsistently, describes the pertinent holding of *LP&L* as limited to "federal curtailment requirements." (*Id.* at 46-47.) The latter description is wrong: *LP&L* suggests no such limitation and, perhaps more important, curtailment rules—a key feature of rules ensuring equal access to the grids—are close to the heart of this case. *See infra* pp. 19-20.

FERC argues further that *LP&L* is distinguishable on the grounds that (a) the federal curtailment requirements in *LP&L* addressed transportation and did not affect retail rate-setting, and (b) regulation of interstate transportation in *LP&L* was necessary to prevent conflicts among the states. (*See* FERC Br. at 37.) But similar conditions obtain here: the OATT addresses interstate transmission, not retail rate-making, and its indirect effect on retail rates is not qualitatively different from the potential indirect effect of the regulations at issue in *LP&L*. And, as further discussed at pp. 17-19, *infra*, the absence of federal regulation of important inter-

state transmission will create jurisdictional gaps and make state conflicts almost inevitable.

EEI's attempts to explain away *LP&L* also fail. EEI's first answer to *LP&L* is that the Court's practice of citing the FPA and NGA interchangeably does not apply to the jurisdictional provisions. (*See* EEI Br. at 42.) EEI is simply wrong. In *FPC v. Southern California Edison Co.*, 376 U.S. 205 (1964), for example, the Court held that its review of the FPA's jurisdictional grants in section 201(b) did not proceed "on a clean slate. . . . The Natural Gas Act grew out of the same judicial history as did the part of the [FPA] with which we are here concerned; and § 201(b) of the Power Act has its counterpart in § 1(b) of the Gas Act . . . ."). *Id.* at 211-12.[3]

EEI also argues that *LP&L* is distinguishable because, EEI asserts, it dealt with section 7(c) of the NGA, a provision with no FPA parallel, which requires natural gas companies to obtain FPC certificates of public convenience before transporting natural gas, 15 U.S.C. § 717f(c). But this Court's confirmation of FPC jurisdiction over all natural gas transportation did not rest on section 7(c), and there is no indication that the Court believed that section 7(c) augmented that jurisdiction. The Court expressly rejected the lower court's holding that FERC must have been acting under its section 7 authority because it lacked jurisdiction under section 1(b), holding instead that the FPC acted under its authority in sections 1(b) and 4. *See LP&L*, 406 U.S. at 643-46.[4]

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[3] *See also United States v. Public Utilities Comm'n of California*, 345 U.S. 295, 310-11 (1953) (noting that NGA precedent "would be as applicable here [interpreting FPA § 201(b)] as to § 1(b) of the [NGA]").

[4] EEI also argues that the NGA precedent is inapposite because the natural gas industry was not characterized by vertically integrated entities, as the electric industry is. But EEI greatly exaggerates. Before the complete unbundling of the gas industry pursuant to FERC Order No. 636, 57 Fed. Reg. 13,267 (Apr. 16, 1992), there had always been significant vertical integration of gas pipelines with both gas production and distribution. *See, e.g., Maryland People's Counsel v. FERC*, 761 F.2d 768, 775 (D.C. Cir. 1985) ("Most, if not all, major gas pipelines . . . are

B. Application of the OATT to Interstate Transmissions Bundled with Retail Sales Is Consistent with the Federal/State Regulatory Scheme of the FPA and Does Not Interfere with Traditional State Regulation.

The general problem addressed in Orders No. 888 and 888-A is relatively new. In the era when vertically integrated utilities, mostly confined to single states, served almost all retail customers on a state-regulated monopoly basis, the problem of competitive access to and usage of the interstate grids was presented only in unusual situations. *See* Order No. 888 at 31,639-47, Pet. App. 140a-161a; (TAPS Br. at 4, 38-41.) The need for general open, nondiscriminatory access arose in the early 1990s, when new federal legislation led to widespread interstate competition to supply electric energy and the new suppliers, lacking transmission facilities, needed access to the facilities owned by the traditional utilities in order to bring electricity into the states where it was needed. *See* Order No. 888 at 31,639-47, 31,651-52, Pet. App. 140a-161a, 170a-172a; (Enron Pet. Br. at 9-11; FERC Br. at 9-12).

This newly acknowledged problem was one that the states had not previously regulated. Traditional state regulation of bundled retail sales did not purport to regulate the

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'backward vertically integrated'—that is, they own significant gas exploration, development and production affiliates.") (citations omitted). And just as in the electric industry, FERC found that the gas pipelines had an incentive to, and did, discriminate in favor of their own and affiliated gas production. *See Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Wellhead Decontrol*, Order No. 636-A, [1991-96 Reg. Preambles] F.E.R.C. Stats. & Regs. ¶ 30,950, at 30,542 (1992) ("major purpose of the Commission in adopting Order No. 636 is to design rules to counter th[e] economic incentive to discriminate in favor of a pipeline's own bundled sales service") (citation omitted), *aff'd in relevant part sub nom. United Distribution Cos. v. FERC*, 88 F.3d 1105, 1125 (D.C. Cir. 1996) (upholding mandatory unbundling to prevent pipelines from providing superior transportation to their own bundled gas sales).

transmission of electric energy across state lines. What EEI describes (Br. at 36) as "five or more decades" of "state commissions . . . asserting jurisdiction over the transmission aspect of such sales" has consisted of state authorities taking transmission costs into account when determining retail rates and imposing service level requirements for their own local customers. (*See* FERC Br. at 46-47.) Application of the OATT to transmissions of energy for bundled retail sale would not displace state regulation: the states would simply continue to take transmission costs (although now subject to the OATT) into account when determining retail rates.[5]

But, more important, the OATT is not primarily about rates at all: it is about setting uniform rules for access to and usage of the interstate grids. As such, the OATT is qualitatively unlike anything any state has ever done or could ever do; it is simply inconceivable that open access could be achieved other than by a federal agency imposing compatible terms on all owners of the facilities that together make up the grids. (*See* TAPS Br. at 31-38.)[6] State commissions have no authority or incentive to impose nondiscriminatory conditions for competitive access to the interstate grids by out of state suppliers servicing out of state users, *see, e.g.*, *Public*

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[5] Contrary to New York's argument (Br. at 6), FPA section 206(d), 16 U.S.C. § 824e(d), which gives FERC authority to investigate and "determine" the cost of interstate transmission "in cases where [FERC] has no authority to establish a rate governing the sale of [the] energy," supports Enron's position: it provides that, even where there is a bundled retail sale, FERC may, on its own motion, decide the costs of interstate transmission.

[6] EEI argues (Br. at 41) that applying the OATT to transmissions bundled with retail sales would impose "a huge regulatory burden and uncertainty on the industry." But as FERC notes (Br. at 43 (citing *FPC v. Conway Corp.*, 426 U.S. 271, 280 & nn.6, 7 (1976)), "the resulting accounting issues would be commonplace." Utilities providing bundled service regularly need to account separately for federally regulated and state-regulated costs. And of course the fact that electric service is unbundled in many states (*see* EEI Br. at 11 n.6) means that the OATT is already broadly applicable to utilities that sell at retail in such states.

Utilities Comm'n of Rhode Island v. Attleboro Steam & Elec. Co., 273 U.S. 83 (1927); *LP&L*, 406 U.S. at 633-36 (noting that conflicting interests among states preclude workable state regulation of interstate natural gas transportation).

Finally, New York and EEI argue (*see* NY Br. at 7, 16; EEI Br. at 40-41) that Enron is attempting to compel FERC to violate FPA section 212(h), 16 U.S.C. § 824k(h), which bars FERC from "requir[ing] the transmission of electric energy . . . directly to an ultimate consumer." But Enron is arguing only that FERC has jurisdiction over transmission in which a utility in fact engages, and that FERC must use that authority to eliminate undue discrimination between users of interstate transmission facilities. Neither FERC nor Enron contemplates giving FERC authority to order direct transmission to an ultimate consumer. *See, e.g.*, Order No. 888 at 31,781, Pet. App. 306a-307a. The significance of section 212(h) for this case is that its express limitation, barring FERC from ordering transmission to retail customers, would be meaningless if, as New York contends, FERC's jurisdiction over interstate transmission extended only to transmissions supporting wholesales.

II. TRANSMISSION-OWNING UTILITIES CAN AND DO DISCRIMINATE AGAINST COMPETING USERS OF TRANSMISSION SERVICE, AND FERC'S FAILURE TO ADDRESS THIS DISCRIMINATION WAS UNLAWFUL.

In the orders under review, FERC found that the "vast majority" of vertically integrated utilities "historically have declined to transport electric energy that would compete with their own sales or have offered access that is inferior to what they use for their own sales," Order No. 888-A at 30,210, Pet. App. 436a-437a, and that "[t]he *only* way . . . to remedy [such] discrimination is through readily available, nondiscriminatory transmission access," *id.* at 30,176, Pet. App. 382a (emphasis added). These findings made no distinction between transmissions for bundled and unbundled retail

sales; on the contrary, the orders find that "all" transmission must be subject to open access if consumers are to realize the benefits of supply competition. *See* Order No. 888 at 31,635, Pet. App. 133a. But even though FERC acknowledged it has a "statutory obligation under sections 205 and 206 of the Federal Power Act" to remedy undue discrimination, *id.*, it simply shrugged that task off with respect to the majority of transmissions on the interstate grids: without explanation or citation to the record, FERC declared that it was "not . . . necessary" to apply the OATT to transmissions where the ensuing sale is bundled retail. *Id.* at 31,699, Pet. App. 235a. The result is a serious regulatory gap.

A. EEI's Argument that There Can Be No Undue Discrimination with Respect to Transmissions Bundled with Retail Sales Is Wrong as a Matter of Both Law and Fact.

EEI suggests (Br. at 46-47) that there can be no "undue discrimination" within the meaning of sections 205 and 206 because (it asserts) alternative suppliers do not compete with vertically integrated utilities for their bundled-service retail customers, and the unbundled-service customers for whom the new entrants compete are not "similarly situated" to the transmission monopolists' bundled native load. This is wrong on both the law and the facts.

First, although EEI attributes to FERC the suggestion that "undue discrimination" can exist only as between similarly situated retail customers (*see id.* at 47), the agency has specifically rejected that narrow conception of discrimination. As FERC noted in Order No. 888, the development of competition after the EPAct required the agency to "broaden[] its undue discrimination analysis (which traditionally had focused on the rates, terms, and conditions faced by similarly situated third-party customers) to include a focus on the rates, terms, and conditions of a utility's own uses of the transmission system." Pet. App. 160a-161a. Transmission monopolists and other suppliers do compete head-to-

head for capacity on the interstate grids, even when they are using that capacity to serve different classes of customers, or customers in different states. For that reason, FERC held, an "open access tariff that is not unduly discriminatory or anti-competitive should offer third parties access on the same or comparable basis, and under the same or comparable terms and conditions, as the transmission provider's uses of its system." Pet. App. 161a (quoting *American Elec. Power Serv. Corp.*, 67 F.E.R.C. ¶ 61,317, at 61,490 (1994)).

Second, EEI's factual premise—that vertically integrated utilities and other suppliers do not compete for the same customers—is incorrect. Even in a "bundled" state, suppliers compete to serve categories of large customers that have a choice to be part of the franchised utility's native load or use an alternative power source. These customers include municipalities,[7] and large industrial users that can build their own on-premises generators or exercise "buy through" rights permitting them, as part of an economic development package, to by-pass their local distribution monopoly and access competitive power suppliers. Such customers remain dependent on the franchised utility's transmission for delivery or back-up service, and the franchised utility can deter the customer from leaving by threatening to favor its own customers and withhold transmission or curtail access for others in times of constrained capacity. *See, e.g.*, Order No. 888 at 31,921, Pet. App. 320a (noting instances where vertically integrated utilities punished "prodigal [*sic*] customers" by withholding needed transmission).

Moreover, other suppliers compete directly with transmission monopolists for the same *wholesale* customers in "bundled" states, and FERC's failure to extend open access to bundled retail load impedes that competition. For example, Enron often competes with a vertically integrated utility

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[7] *See, e.g.*, Order No. 888 at 31,920, 31,923-25, Pet. App. 316a-319a, 324a-330a (examples involving AMP-Ohio and various California municipalities).

to sell electricity to other, neighboring utilities, and to do so Enron's only, or most economical, transmission may be through the first utility's bundled-service territory. The exemption from open access for transmissions to serve bundled customers gives that utility an effective chokehold over Enron's "through" transmission: Specifically, that utility can tie-up for native load some or all of its incoming transmission capacity, thereby denying Enron "through" service or forcing Enron to schedule around the utility's bundled service territory. Order No. 888 cites several examples of strategic tying-up of transmission capacity, nominally for bundled transmissions, in order to block access by competing sellers. *See, e.g., id.* at 31,920, 31,923-24, Pet. App. 317a-318a, 325a-328a (examples of utilities manipulating reservation of transmission capacity to discourage competition).

EEI's suggestion (*see* Br. at 47-48) that the exemption from open access for bundled transmission can somehow be justified as a protection for residential customers that cannot choose their suppliers inadvertently proves Enron's point. A state might *want* to give its own residents transmission priority over wholesale purchasers, but it does not and should not have jurisdiction to do so. On the contrary, the disadvantaged wholesale customers often are other utilities or municipalities with their own residential customers to serve; denying them equal access simply shifts the burden from residential users in one state to residential users in another.[8]

B. FERC's Arguments that Coverage of Transmission for Bundled Service Is Not "Necessary" Are Also Unavailing.

FERC suggests (Br. at 47) that its failure to extend open access to bundled transmission was actually a reasoned determination based on the state of the factual record then be-

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[8] EEI's justification for distinguishing bundled from unbundled transmission service is not one that FERC ever invoked itself. *Cf. SEC v. Chenery Corp.*, 332 U.S. 194, 196 (1947).

fore it. The portions of the orders FERC cites demonstrate otherwise. The *entirety* of Order No. 888's analysis of the factual record on "necessity" reads as follows:

> Although the unbundling of retail transmission and generation, as well as wholesale transmission and generation, would be helpful in achieving comparability, we do not believe it is necessary.

Pet. App. 235a. FERC's other citation to its purported analysis of the factual record is simply the rehearing order's recitation of what the agency said the first time. *See* Pet App. 453a-454a. The claim that these passages represent a reasoned judgment that the factual record did not support an extension of open access is a considerable stretch.

In fact, as demonstrated above and in Enron's opening brief (*see* Pet. Br. at 12-13, 36-38), Order No. 888 contains detailed findings of pervasive undue discrimination by vertically integrated utilities providing bundled service to their native loads, and none of these findings suggests that the prevalence or impact of discrimination turns on how the transmission is invoiced to the retail customer.[9] On the contrary, Order No. 888 proclaims that extending open access to bundled transmission would be "helpful" in stopping the discrimination that FERC had found. Pet. App. 235a. FERC's Notice of Proposed Rulemaking recognized that limiting open access to unbundled transmission would "result in service under two separate arrangements—an explicit wholesale transmission tariff filed at the Commission and an implicit retail transmission tariff governed by a state regulatory body," presenting the risk that "the quality of transmission service for retail purposes will be superior to the quality of transmission service offered for wholesale purposes." Order No. 888-A at 33,081-82, Pet. App. 634a. FERC expressly "s[ought] comment on how this bifurcated approach would

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[9] In fact, because there was little or no unbundling prior to Order No. 888, all of FERC's findings of undue discrimination occurred in bundled states.

affect the public utility's incentives to provide non-discriminatory open access wholesale transmission service," *id.* at 635a, and the comments Enron and other parties filed provided ample justification for extending open access to bundled transmission.[10]

FERC's suggestion (Br. at 47) that Enron has never established the need for a *federal* role with respect to bundled transmission, or demonstrated the practical limitations of state regulation, is wrong. Enron made such a showing throughout the administrative proceeding.[11] It is evident that where a transmission line crosses state boundaries, the states through which that line passes cannot each adopt a rule giving its own bundled in-state customers priority rights to use the line's capacity. As the Pennsylvania PUC emphasizes, "[a]n interstate transmission system riddled with 'holes' or 'blockades' created by the erection of local State rules seeking to protect 'native' bundled retail load would be injurious to interstate commerce, retail competition, regional reliability and at odds with Congressional intent." (Br. at 3; *see also id.* at 12-13.) Current events in the West are demonstrating that the competitive energy supply markets Congress created are

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[10] Enron participated in the Order No. 888 rulemaking as a member of the Coalition for a Competitive Electric Market, which submitted comments advocating extension of the OATT to bundled retail transmissions. *See, e.g., Initial Comments of The Coalition for a Competitive Electric Market*, Nos. RM95-8-000 et al. (July 12, 1995) (*CCEM Initial Comments*) at 10 ("ineluctably discrimination will persist until there is a total unbundling and consumers of all transmission services, wholesale and retail, take service pursuant to a tariff at posted rates"); *id.* at 4-10; *see also Comments of the Transmission Access Policy Study Group On Major Policy Issues*, Nos. RM95-8-000 et al. (Aug. 7, 1995) at 12, 27-30; *Request for Clarification and Rehearing of the Transmission Access Policy Study Group and Certain of Its Members*, Nos. RM95-8-000 et al. (May 24, 1996) at 8-13.

[11] *CCEM Initial Comments* at 5-6, 13; *see also Comments of the Transmission Access Policy Study Group on Basic Assumptions*, Nos. RM95-8-000 et al. (May 24, 1996) at 2 ("a working infrastructure for a market must be established by [FERC]").

regional and national; they are also demonstrating that individual states face powerful pressures in times of shortage to hoard supply for in-state uses and to prevent the transfer of electricity across state lines. As this Court recognized well before any state had implemented retail unbundling, the "transmission of energy is an activity particularly likely to affect more than one State, and its effect on interstate commerce is often significant enough that uncontrolled regulation by the States can patently interfere with broader national interests." *Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 377 (1983) (citations omitted). FERC is the only entity capable of adopting consistent regulations and safeguarding the national interest.[12]

FERC also (inadvertently) acknowledges, in its discussion of unbundled transmission, the inherent limitations on state power that create a regulatory gap applicable to bundled transmissions as well. FERC explains (Br. at 38) that if a retail customer's state has sole jurisdiction to regulate transmissions to serve that customer, then no authority, federal or state, can regulate transmission service through "intervening" states whose facilities are part of the grid that connect the generator and the customer:

> If the State in which the retail customer is located has jurisdiction to regulate all unbundled transmission associated with a retail sale, there would be a

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[12] New York's lengthy recitation of state-law analogues to the antidiscrimination provisions of the FPA and case law thereunder (*see* NY Br. at 19-23) proves nothing; as New York describes these cases, none involves protection of an out-of-state electric supplier against discriminatory reservations of capacity for in-state customers of in-state utilities. New York does not explain how it could impose consistent usage rules for the out-of-state portions of multistate transmission lines. And even taking New York at its word that it stands ready to police discrimination against out-of-state grid users, there is no guarantee other states will do likewise. Just the opposite: California has filed a brief in this case defending its claimed power to discriminate in favor of in-state users when there is a shortage of transmission capacity. (*See* Cal. Br. at 29.)

> large regulatory gap when the retail customer purchases power from a supplier in a distant State, and that supplier requires transmission service from intervening out-of-state utilities to deliver the power. The intervening transmission would be beyond the jurisdictional reach of the consumer's State . . . [and] would not be subject to meaningful regulation.

FERC means to be answering New York's contention that the states, not FERC, have jurisdiction over transmission to serve unbundled retail customers, but the point applies equally to transmission that serves bundled retail customers: absent FERC jurisdiction there can be *no* effective regulation of such transmission insofar as it implicates facilities in states other than the state of the retail customer. And FERC cannot fully protect the choices of retail customers in unbundled states if it cannot fully regulate the portions of the interstate grid that lie in "intervening" bundled states. (*See* TAPS Br. at 31-38.)

FERC seeks to reassure the Court that it can, in fact, police discrimination with respect to bundled transmission. (*See* Br. at 48; *see also* EEI Br. at 48-49.) FERC points to a later order (Order No. 2000) authorizing the creation of independent "regional transmission organizations" that would operate each grid in place of the vertically integrated utilities (*see* Br. at 47-48 n.23). But the formation of such organizations is entirely voluntary, *see* FERC Order No. 2000, 65 Fed. Reg. 810, 831-35 (Jan. 6, 2000), and one would not expect that the current monopolists—whose "inherent" incentives, FERC found, "make it inevitable that they will act in their own self-interest to the detriment of others by refusing transmission and/or providing inferior transmission to competitors," Order No. 888 at 31,682, Pet. App. 214a—would willingly give up their strategic control over the transmission grids. FERC also states that it "continues to believe" it has full authority to prevent transmission monopolists from providing bundled transmission in a manner that disadvantages unbundled services subject to its jurisdiction. But in one of

the critical situations—the determination of whether a utility can favor its own bundled service when system conditions require curtailment of transmission—the Eighth Circuit, following FERC's own reasoning here, held otherwise. *See Northern States Power Co. v. FERC*, 176 F.3d 1090 (8th Cir. 1999) (*NSP*), *cert denied*, 528 U.S. 1182 (2000).[13] FERC's unlawful abdication of its jurisdiction prevents it from playing the role that its own findings show is necessary.

CONCLUSION

The decision of the court of appeals sustaining FERC's abdication of jurisdiction over interstate electric transmission for bundled retail sales should be reversed.

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[13] For the same reason, EEI's suggestion that in a curtailment situation "customers under the Order No. 888 open access tariff must receive the same degree of firmness as the utility's native load" rings hollow: this was the very requirement of Order No. 888 that the Eighth Circuit overturned on the basis of FERC's erroneous conclusion that it lacks jurisdiction over bundled transmissions. *NSP*, 176 F.3d at 1096 (overturning Order No. 888 requirement that firm transmission service to third parties be just as firm as bundled transmission to native load). Nor does FERC's limited ability to investigate vertically integrated utilities' purported reservations of transmission capacity for native load in individual cases, many months after the damage to competitors is done in the marketplace (*see* EEI Br. at 48-49), substitute for a self-enforcing structural remedy like the OATT, assuming that the ability to investigate even survives *NSP*.

Respectfully submitted,

JEFFREY D. WATKISS
BRACEWELL & PATTERSON, L.L.P.
2000 K Street, N.W.
Suite 500
Washington, D.C. 20006
(202) 828-5800

JOSEPH R. HARTSOE
SARAH NOVOSEL
ENRON CORP.
1775 I Street, N.W.
Washington, D.C. 20006
(202) 828-3360

LOUIS R. COHEN
Counsel of Record
JOSEPH E. KILLORY, JR.
JONATHAN J. FRANKEL
IJAY PALANSKY
MICHAEL PLOTNICK
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, D.C. 20037-1420
(202) 663-6000

Counsel for Petitioner Enron Power Marketing, Inc.

July 2, 2001

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Nos. 00-568 and 00-809

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MAY 31 2001

IN THE

Supreme Court of the United States

PEOPLE OF THE STATE OF NEW YORK AND THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

ENRON POWER MARKETING, INC.,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF FOR THE PENNSYLVANIA PUBLIC UTILITY COMMISSION AS *AMICUS CURIAE* SUPPORTING RESPONDENTS

BOHDAN R. PANKIW
Chief Counsel
KAREN O. MOURY
Deputy Chief Counsel
JOHN A. LEVIN *
Assistant Counsel
PENNSYLVANIA PUBLIC UTILITY COMMISSION
Post Office Box 3265
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17105-3265
(717) 787-5978

* Counsel of Record

Counsel for Amicus Curiae the Pennsylvania Public Utility Commission

BEST AVAILABLE COPY

– WASHINGTON, D. C. 20001

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On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*

The Pennsylvania Public Utility Commission (Commission) hereby respectfully moves for leave to file the attached brief *amicus curiae* in this case, having failed to secure the consent of all parties.

There are a large number of parties in this case. The consent of all parties was sought by letter dated May 17, 2001 forwarded to each party on the Court's official docket list by overnight courier or United States Express Mail.

As of the date of the printing of this brief, 58 parties have consented and none have refused consent. Four requests were returned as undeliverable and 65 parties have not responded to our request as of the printing date of this brief.

The interest of the Commission in this proceeding is as a State agency which, pursuant to State legislation, has restructured its electric industry for the purpose of introducing retail competition, and which views the Federal Energy Regulatory Commission Order under attack as vital to the success of retail competition and the economic health of the Mid-Atlantic region. The Commission's views are not adequately represented by petitioners, respondents or other parties. It is believed that the views contained herein will provide more complete view of the Constitutional and statutory issues involved.

Respectfully submitted,

BOHDAN R. PANKIW
Chief Counsel
KAREN O. MOURY
Deputy Chief Counsel
JOHN A. LEVIN *
Assistant Counsel
PENNSYLVANIA PUBLIC UTILITY COMMISSION
Post Office Box 3265
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17105-3265
(717) 787-5978

* Counsel of Record

Counsel for Amicus Curiae the Pennsylvania Public Utility Commission

QUESTION PRESENTED IN NO. 00-568

Whether, given that Congress in 1935 stated that federal regulation extends "only to those matters which are not subject to regulation by the states" (Section 201(a) of Federal Power Act), and transmission of energy from generators to retail customers in the same State was then "subject to regulation by states" (as it has been since 1935), may FERC preempt State jurisdiction over such intrastate retail transmissions of electric energy?

QUESTIONS PRESENTED IN NO. 00-809

Whether the Federal Energy Regulatory Commission (FERC) has jurisdiction under the Federal Power Act (FPA), 16 U.S.C. §§ 798 *et seq.*, to regulate all transmission of electric energy in interstate commerce, including interstate transmission of electric energy that is sold to retail customers at a "bundled" price?

Whether FERC had jurisdiction and the obligation under the FPA to eliminate pervasive "undue discrimination" in the provision of interstate electric energy transmission services by requiring transmission-owning utilities to provide interstate transmission services on the same terms to all users, for all interstate transmissions, including transmissions bundled with retail sales?

Whether the court of appeals erred in ruling that FERC had discretion to interpret the FPA as denying FERC the necessary jurisdiction to remedy the undue discrimination it had found in the provision of interstate transmission?

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STATEMENT OF *AMICUS* INTEREST [1]

The Pennsylvania Public Utility Commission is a State administrative commission created by the General Assembly of the Commonwealth of Pennsylvania and is charged with the regulation of electric utilities and licensing of generation suppliers within the Commonwealth of Pennsylvania. 66 Pa.C.S. § 101, *et seq.* The Commonwealth of Pennsylvania continues to be involved in the restructuring of the Commonwealth's retail electric energy industry pursuant to the Commonwealth's *Electricity Generation Customer Choice and Competition Act*, 66 Pa.C.S. § 2801-2812 ("Pennsylvania Electric Competition Act"). Since January 2, 2000, nearly all retail electric customers in the Commonwealth have had the right to select a competitive retail electric generation supplier according to the terms of the Pennsylvania Electric Competition Act. As the success of the retail electric market is dependent upon a well-functioning regional wholesale generation market, the Commission urges this Court to sustain the orders below. FERC's conclusion that the Federal Power Act requires interstate transmission service to be provided on the same terms and conditions for all is in accord with law and Congressional intent. The Pennsylvania Commission supports FERC's orders[2] carrying

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[1] Rule 37.6 Statement: John A. Levin, Assistant Counsel to the Pennsylvania Public Utility Commission, is the author of this brief. No person or entity other than the Pennsylvania Public Utility Commission has made a monetary contribution to the preparation or submission of this brief.

[2] *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888*, F.E.R.C. Stats. & Regs. ¶31,036 (1996), *order on reh'g, Order No. 888-A*, F.E.R.C. Stats. & Regs. ¶ 31,048 (1997), *order on reh'g, Order No. 888-B*, 81 F.E.R.C. ¶61,248 (1997), *order on reh'g, Order No. 888-C*, 82 F.E.R.C. ¶61,046 (1998), *aff'd in part and remanded in part sub nom. Transmission Access Policy Study Group, et al. v. F.E.R.C.*, 225 F.3d 667

out the intent of Congress's enactment of the Energy Policy Act of 1992. FERC's jurisdiction over the provision of interstate transmission service under the Federal Power Act does not change whether the power to be transmitted is carried to a State which permits retail electric competition or to a State which continues to regulate bundled retail service in traditional fashion. A State may not, under the guise of local regulation, place an undue burden upon interstate commerce and the interstate transmission system.

SUMMARY OF ARGUMENT

This Court determined, in *Rhode Island PUC v. Attleboro Steam*, 273 U.S. 83 (1927) that interstate electric transmission service could not lawfully be regulated by the States based upon repugnance of such regulation to the Commerce Clause. U.S. Const. Art. 1, § 8, cl. 3. In the intervening years, it became apparent to Congress that there was an important regulatory gap created by the unregulated growth of the electric system across State lines, accompanied by changes in technology. Congress's response was to fill the regulatory gap eight years later by passage of the Federal Power Act of 1935, 16 U.S.C. §§ 792 *et seq.*. Through the Federal Power Act, the federal government assumed jurisdiction over the rates, rules and regulations of bulk power sales and interstate transmission, while the States regulated the provision of intrastate transmission service then associated with the bundled retail sales of electricity to end users. This regulatory paradigm remained more or less static until 1992.

In 1992, Congress passed the Energy Policy Act of 1992 (EPAct), containing provisions codified at 16 U.S.C. §§ 824j-824m introducing open access to the transmission grid and

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(D.C. Cir. 2000), *pet. for cert granted sub nom. People of the State of New York v. F.E.R.C.*, No. 00-568 and *Enron Power Marketing, Inc. v. F.E.R.C.* (Order No. 888), __ U.S. __, 149 L. Ed. 102, 121 S. Ct. 1185 (U.S. 2001) (*Order 888*).

competition to wholesale generation markets. The creation of wholesale competition provided the necessary predicate to retail competition. Orders 888, challenged here by both Petitioners New York and Enron, was FERC's comprehensive implementation of the regulatory changes wrought by EPAct.

As a State that has been among the leaders in the introduction of retail electric competition[3], Pennsylvania has an important stake in the wholesale generation market protections created by FERC Orders 888 and 889. An interstate transmission system riddled with "holes" or "blockades" created by the erection of local State rules seeking to protect "native" bundled retail load would be injurious to interstate commerce, retail competition, regional reliability and at odds with Congressional intent.

The electric transmission grid of 1928 or 1935 or 1992 is not the electric transmission grid of today. Industries can and do grow from localized markets with little effect on interstate commerce to national markets spanning many or all states. Wholesale generation markets are becoming increasingly regional and multi-state in character. FERC's reorganization of transmission under "Open Access Transmission Tariffs" and the control of Independent System Operators and

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[3] Of 1.2 million customers eligible to shop for competitive retail power in Pennsylvania in March, 1999, 400,000 had actually switched, about 33 percent of peak winter load. Testimony of John M. Quain, Chairman, Pennsylvania Public Utility Commission, *Evolving Federal and State Roles, Hearings before the House Subcommittee on Energy and Power*, 106th Congress at 91 (March 18, 1999) As of October 2000, more than 550,000 Pennsylvania customers were purchasing power from a competitive supplier. In 1997, retail rates were on average 15% higher than elsewhere in the United States. In February, 2001, Pennsylvania rates were 4.4% lower on average. Testimony of John M. Quain, Chairman, Pennsylvania Public Utility Commission, *Electricity Markets, Hearings before the House Subcommittee on Energy and Air Quality*, 107th Congress at 91 (February 15, 2001)

Regional Transmission Organizations are both a reflection and a necessary facilitator of this trend. Regional markets cannot effectively operate where individual states are permitted to carve out portions of the common grid in promotion of local policies or local industries. Congress cannot be presumed to have opened up the transmission grid to competition through the enactment of EPAct, only to see its policy chopped apart by individual States or the political subdivisions of States seeking to advance local parochial interests under the guise of the exercise of "traditional police powers".

ARGUMENT

I. ORDER 888 AND THE EXERCISE OF STATUTORY AND FEDERAL COMMERCE CLAUSE AUTHORITY BY FERC IS SUPPORTED BOTH BY LAW AND BY CHANGES IN THE NATIONAL TRANSMISSION SYSTEM

A. The Legislative History of The Federal Power Act and the Energy Policy Act of 1992 Demonstrates That Congress Intends to Create a Vibrant Wholesale Generation Market

Transmission facilities, prior to EPAct, were universally operated by and for the benefit of the vertically integrated monopoly owners of such facilities. The provisions of the Federal Power Act were crafted by Congress to encourage voluntary, not mandatory, interconnections of transmission networks. *Otter Tail Power Co. v. United States,* 410 U.S. 366 (1973). As this Court noted in *Otter Tail:*

> As originally conceived, Part II would have included a "common carrier" provision making it "the duty of every public utility to . . . transmit energy for any person upon reasonable request . . ." In addition, it would have empowered the Federal Power Commission to order wheeling if it found such action to be "necessary or

> desirable in the public interest." H. R. 5423, 74th Cong., 1st Sess.; S. 1725, 74th Cong., 1st Sess. These provisions were eliminated to preserve "the voluntary action of the utilities." S. Rep. No. 621, 74th Cong., 1st Sess., 19. It is clear, then, that Congress rejected a pervasive regulatory scheme for controlling the interstate distribution of power in favor of voluntary commercial relationships.

Otter Tail, at 374.

Although the then-existing provisions of Section 202 of the Federal Power Act, 16 U.S.C. § 824a, authorized FERC's predecessor, the Federal Power Commission (FPC), after hearing, to order interconnections between transmission facilities, this provision was generally interpreted as authority to require interconnections between utilities, not as authority to force utilities to act as common carriers.

Even so, this Court found it within the FPC's powers in 1952 to compel a Pennsylvania electric utility to continue its existing interconnection arrangement with a Maryland utility for the benefit of Maryland retail consumers, even "notwithstanding the fact that system energy transactions at some particular times may involve energy never crossing the State boundary." *Pennsylvania Water & Power Co. v. F.P.C.,* 343 U.S. 414 at 420 (1952), *citing, Pennsylvania Water & Power Co.,* 8 F.P.C. 1, 37 (1949). It should be noted that while *U.S. v. Public Utilities Commission of California,* 345 U.S. 295 (1952) usefully summarizes the intent of Congress with regard to the Federal / State jurisdictional issues prior to 1952, it and similar federal/state jurisdictional cases no longer control this case because of the enactment of EPAct in 1992.

EPAct signalled the intent of Congress that a sharp departure was to be made in the method and scope of regulation of the interstate transmission grid. The language of Title VII, Section 721 of EPAct, 16 U.S.C. § 824j, was a revolution in electric transmission regulation. For the first

time since the start of the electric power industry, any person could request transmission service to convey power from one point to another point for resale. This statutory provision was the launch by Congress of a wholesale electric generation market in the United States which implicitly encouraged, but did not require a parallel development by the States of a competitive retail generation market. It is indeed difficult to conceptualize any development of electric retail competition without a preexisting wholesale generation market. By permitting non-utility generation providers access to the grid, Congress was also encouraging an end to the traditional vertically integrated electric utility monopoly that had been the unchallenged United States model for most of the 20th century.

EPAct Title VII contained other important provisions. Section 711 of EPAct amended the Public Utility Holding Company Act of 1935 (PUHCA), 15 U.S.C. § 32, to create a new purely wholesale generation entity, the "exempt wholesale generator" which, subject to FERC review, would be exempt from the regulatory provisions of PUHCA. Thus Congress created a new kind of market participant for the new competitive wholesale generation market—exempt wholesale generators, free of geographic restrictions and monopoly utility control that would compete with incumbent monopoly generation and bring about market based prices and market reform.

The provision upon which New York principally relies, EPAct § 722, amends Section § 212 of the Federal Power Act by the addition of subsections (g)-(k), specifically subsection (h) "Prohibition on Mandatory Retail Wheeling and Sham Wholesale Transactions", 16 U.S.C. § 824k (h). The context of this subsection indicates Congress's overarching intent to create a wholesale generation market in interstate transmission of electricity while giving States flexibility to create retail electric competition or not, as each State

determined to be its policy. If States wish to introduce retail competition, EPAct creates the required wholesale generation market infrastructure. If not, States cannot be forced, through a Section 212 interconnection order to open up their retail markets to competition.

Congress never intended to and did not grant States the power to defeat Congress's creation of a wholesale transmission market by interposing parochial State burdens on the portions of the transmission grid which happened to be located in that State. While reserving to the States their preexisting power to regulate jurisdictional monopoly retail electric utility service as States had for most of the 20th Century, Congress did not intent to cede any of its jurisdiction over interstate transmission. Congress had no intent to impair the national wholesale electric generation market which it had created with the same stroke of the pen.

New York's *Brief on the Merits* erroneously conflates State ratemaking powers with rules controlling the operation of the interstate transmission network. Transmission rates are actually a relatively small component of retail electric rates. It is clear from New York's argument (and even more so from the novel theory advanced by California as *amicus curiae)* that retail rates are not the issue here. Network control and "rules of the road" are what is being fought over. Who controls the interstate grid gets to decide a great many things, including wholesale generation market design and which wholesale electricity transactions will flow and which will be cut or reduced.

Thus, New York's position that the matter before you is really a rate case and its citation of *Duquesne Light and Penn Power v. Barasch,* 488 U.S. 299 (1989) in support of that proposition is ironic in two respects.

First it is a *non sequitur*. The issues in this case clearly do not involve public utility rates or a claim that FERC has engaged in an unconstitutional "taking" of utility property, a

claim which New York would lack standing to advance in any event. In *Duquesne*, two Pennsylvania utilities challenged a Pennsylvania ratemaking statute involving State laws governing the valuation of *intra*state generation assets for State ratemaking purposes. Second, as this Court recognized in *Duquesne*, when utility regulatory schemes change, states must fairly adjust their rules and methods of regulation to accommodate such changes.

> The risks a utility faces are in large part defined by the rate methodology because utilities are virtually always public monopolies dealing in an essential service, and so relatively immune to the usual market risks. Consequently, a State's decision to arbitrarily switch back and forth between methodologies in a way which required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others would raise serious constitutional questions. But the instant case does not present this question.

Duquesne at 315.

Here, "methodologies" have clearly changed, at Congress's behest. New methodologies of participation and cooperation are necessary, both on FERC's behalf and on behalf of the States to ensure that the growing wholesale generation market in electricity generation is not hampered or destroyed by fragmentation of jurisdiction over the transmission grid.

In its *Brief for Respondents* in No. 00-809 New York cites to the decision of the Eighth Circuit in *Northern States Power v. F.E.R.C.*, 176 F.3d 1090 (CA 8th Cir. 1999), *cert. den sub nom. Enron Power Marketing Inc. v. Northern States Power Co.*, 528 U.S. 1182 (2000) for the principle that Congress intended that a State has jurisdiction to protect its "native load" customers by ordering that they receive preferential transmission service, whether or not that burdened interstate commerce. That decision is manifestly erroneous and this

Court should expressly overrule it. *See* William H. Penniman and Paul B. Turner, *A Jurisdictional Clash over Electricity Transmission: Northern States Power v. F.E.R.C.*, 20 Energy L. J. 205 (1999).

B. The Development of Pennsylvania Retail Competition Is Based Upon A Vibrant Wholesale Generation Market and An Interstate Grid Not Controlled by Parochial Local Interests

Prior to 1997, and the start of retail competition in the Commonwealth of Pennsylvania, the Pennsylvania Commission shared many of the views on jurisdiction presently being advanced by New York. The Pennsylvania Commission participated in the rulemaking proceedings that led to the issuance of Order 888, and in our May 23, 1996 petition for rehearing, the Pennsylvania Commission told FERC that it lacked jurisdiction to redefine its jurisdiction over interstate transmission in the manner that it ultimately did. At that time, none of the States had any actual experience with retail competition made possible by the existence of a nascent wholesale generation market. Pennsylvania's extensive and actual experience with the operation of competitive wholesale and retail generation markets has been the basis of a major evolution of our perspective.

The Pennsylvania Electric Competition Act was signed into law on December 3, 1996 and became effective January 1, 1997, contemporaneously with the development of the open access rules being developed in FERC's *Order 888* proceeding. The concepts and mechanisms being advanced by FERC in its *Order 888* rulemaking, particularly those provisions that sought to create a national wholesale generation market and transmission system free of undue discrimination or market power, played a central role in the development and eventual passage of the Pennsylvania Electric Competition Act.

The Pennsylvania Electric Competition Act was drafted contemporaneously with FERC's restructuring of the national wholesale generation markets through its Order 888 rulemaking and reflects FERC's restructuring efforts. For example, Pennsylvania legislative findings at 66 Pa.C.S. §2802 (1), (3), (5), (13), (15), (19) and (20) note recent changes in Federal law and policy which restructured previously regulated industries to competitive markets. 66 Pa.C.S. § 2802 (19) encourages all market participants to coordinate plans and transactions through a [FERC approved] independent system operator or functional equivalent.

66 Pa.C.S. § 2803 defines "direct access" as "the right of electric generation suppliers and end-use customers to utilize and interconnect with the electric transmission and distribution system on a nondiscriminatory basis at rates, terms and conditions of service comparable to the transmission and distribution companies' own use of the system to transport electricity from any generator of electricity to any end-use customer", a standard comparable to FERC's "open access" standard in Order 888. All of these provisions reflect Pennsylvania's reliance on the Federal restructuring rules embodied in *Order 888*.

The Pennsylvania Commission, assigned by the Pennsylvania General Assembly the task of implementing the Pennsylvania Competition Act, relied heavily upon the interstate transmission and wholesale generation market restructuring process that FERC has undertaken in *Order 888*, particularly with respect to FERC's guarantee of open access to the regional transmission grid to all wholesale generation market participants. *Electric Utility Restructuring Filings Made Pursuant to 66 Pa.C.S. § 2806(E)*, 176 PUR 4th 45 (Pa.P.U.C. 1997). A major concern of Pennsylvania was that "Electric industry restructuring should ensure the reliability of the interconnected electric system by maintaining the efficiency of the transmission and distribution system." *Id.* at 49, *citing* 66 Pa. C.S. §2802 (12).

Most of Pennsylvania's transmission grid is under the operational control of one of the nation's first independent system operators, created by FERC pursuant to the "open access" principles of *Order 888*[4]. PJM Interconnection, L.L.C. (PJM) controls the transmission facilities of nine transmission owning companies in the States of Pennsylvania, New Jersey, Maryland, Delaware and the District of Columbia. PJM's Open Access Transmission Tariff, as approved by FERC, permits anyone in the PJM region, upon joining PJM and signing its agreements to transport electric energy for resale over PJM controlled transmission facilities and pay a single networked tariff.

Market based wholesale generation pricing authority has been granted by FERC to numerous participants in the PJM region, including generation owners which also own or control transmission facilities. Such market pricing authority has been granted expressly *because* market power concerns have been adequately addressed by PJM's independent control of the region's transmission facilities. *Order Approving PJM Supporting Companies' Request for Market-Based Pricing Authority,* 86 F.E.R.C. ¶ 61,248 (1999). Absent transmission system control by an independent entity, FERC correctly concludes that a transmission owner that also participates in the wholesale generation market has great incentive and opportunity to disadvantage generation competitors without such control.

The PJM ISO control area is expanding, increasing the size of the Mid-Atlantic regional market for wholesale electricity. The Allegheny Power System, which serves portions of

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[4] *Pennsylvania - New Jersey - Maryland Interconnection,* 81 F.E.R.C. ¶ 61,257 (1997), *order on clarification,* 82 F.E.R.C. ¶ 61,068 (1998), *order on reh'g,* 92 F.E.R.C. ¶ 61,782 (2000), *appealed sub nom Baltimore Gas and Electric Co. v. F.E.R.C.,* Case No. 00-1460 (CA District of Columbia) and *Public Service Electric and Gas Company v. F.E.R.C.,* Case No. 00-1457 (CA District of Columbia).

western Pennsylvania, Maryland, Ohio, Virginia and West Virginia has already announced plans to join PJM. *Allegheny Power System on behalf of Monongahela Power Company, The Potomac Edison Company, West Penn Power Company, PJM Interconnection, L.L.C., Allegheny Power Service Corporation*, 95 F.E.R.C. ¶ 61,045 (2001). Duquesne Light Company has announced similar tentative plans to join PJM. *Duquesne Light Co.*, F.E.R.C. Docket No. RT01-13-000, *Status Report of Duquesne Light Company*, (December 5, 2000).

Thus, most of Pennsylvania is or will soon be served by an Independent System Operator which spans much of the Mid-Atlantic seacoast of the United States from New Jersey to Virginia, including the District of Columbia and seven States.

C. Parochial State Rules Which Burden the Operation of the Interstate Transmission Network Burden Interstate Commerce Present Obstacles To Congress's Plan For Wholesale Competition and Endanger the Reliability of the Interstate Transmission Network

New York's view is that any transaction, wholesale or retail, which begins and ends in a single State is wholly State jurisdictional regardless of its impact on the interstate transmission network. If that is true then there is no limit to a State's authority to give preference to such transactions over interstate commerce, even to the point of blocking such transactions entirely. "State" police powers are also exercised by political subdivisions of states, such as "utility districts" or municipal light and heating authorities. While such State political entities exercise "traditional police powers" they are also connected to the interstate grid. There is considerable scope for mischief in such a misreading of the Federal Power Act. A State or political subdivision located along a path of interstate transmission congestion or strategic importance

could, by preferential scheduling of power transactions, equipment outages or emergency operations, control a large portion of the interstate grid.

For example, PJM members are signatories to a number of agreements, including an Operating Agreement and a Reliability Agreement, which obligate PJM wholesale generation market participants, transmission owners, generation owners and local distribution companies to coordinate system operations, system outages, voltage reductions and load dumps in times of serious shortages. Such coordinated control and response is essential to transmission system security. Under New York's theory, any State (or political subdivision with transmission resources or control) could substitute its own judgment during a regional, multi-state emergency.

There is nothing hypothetical or speculative about such concerns. The City of Vernon, California filed a recent complaint with FERC asking it to relieve the City of the obligation to interrupt during times of California transmission system emergency declared by the California ISO. *City of Vernon, California v. California Independent System Operator,* F.E.R.C. Docket No. EL01- 75-000 (Complaint filed May 7, 2001). In its complaint, the City declares:

> It is widely reported that California is likely to suffer shortages of power supply this summer. Some projections are that as a result of such shortages blackouts will be required for 30 days or more. In the past, when the ISO system, or a portion of that system, was short of energy in real time, the ISO has imposed rotating blackouts that required all utilities to blackout a portion of their load on a pro rata basis with other utilities on the ISO system generally or on the particular affected portion of the system. Whether the particular utility was fully resourced or fully scheduled or not, was not taken into account . . . [T]he ISO's response to Vernon is that the failure or inability of other utilities to schedule sufficient supplies for their load, and the ISO's inability

> to makeup the shortfall with real time imbalance energy, constitutes a "system emergency". The ISO contends that under its tariff and various agreements to which Vernon is a party, Vernon and all other utilities in the affected area must curtail their customers' load on the same pro rata basis in such system emergencies . . .
>
> However, the present circumstances are not "system emergencies" within that meaning. The present circumstances are the results of choices made by or for the utilities that find themselves short of supply. They are not the result of some sudden and unexpected calamity.

City of Vernon, California v. California Independent System Operator, F.E.R.C. Docket No. EL01-75-000 (Complaint filed May 7, 2001) at 3-9.

The prospect of a California municipality sitting as a lighted island while its neighbors struggle in the darkness to cope with a chronic system emergency is a vision of chaos. The City of Vernon's demand would impair California's and the Western Interconnection's efforts to battle a serious regional shortage of electricity and transmission capacity and spark disputes which could lead to the fragmentation of the regional transmission grid. Indeed, the City's complaint is a harbinger of the future of the interstate transmission grid as New York would have it controlled under a system of fragmented jurisdiction.

Whatever the ultimate resolution of the *City of Vernon* complaint, FERC must assess the complaint's effect on reliability, 16 U.S.C. §824j (b), and its impact on the interstate transmission system, 16 U.S.C. §824k. FERC is obligated under the Federal Power Act to protect the reliability and integrity of the larger interstate transmission system as a whole, so as to protect the national public interest.

New York would put itself in FERC's place in resolving such disputes. New York claims a unilateral and seemingly unconstrained power, free of FERC review or jurisdiction, to "protect" a certain class of New York retail customers by running those portions of the New York transmission system it deems "intrastate". It would do so by carving out superior rights to facilities that are part of the interstate transmission system, to the detriment of neighboring regions. While New York is understandably vague on the details of how it would exercise this asserted power, the harm to interstate commerce is clear. There will be two classes of firm transmission service in New York: "Bundled Retail Firm" and "Interstate Commerce Firm". Interstate commerce will be less firm than New York's bundled retail load and the degree of burden upon interstate commerce will be at New York's behest.

Pennsylvania and other states which depend upon a well functioning wholesale transmission system and competitive wholesale generation market cannot avoid being disadvantaged by such a claim. With wholesale transactions frequently spanning states and regions, every State through which any portion of a transaction might flow could assert jurisdiction to regulate or impede it. Indeed, as electric energy does not flow directly from one point to another, but over many parallel pathways in the interstate transmission grid, nearly every wholesale power transaction in the Eastern Interconnection could conceivably come under New York's jurisdiction. *See North American Electric Reliability Council,* 85 F.E.R.C. ¶ 61,353 (1998).

The development and operation of regional independent system operators such as PJM is threatened as well. Pennsylvania regards such regional transmission organizations, which operate regional transmission grids under common control and market rules, as essential to well functioning wholesale and retail markets. With regional wholesale generation markets gradually increasing in size, it

is important that the interstate grid be protected against efforts to carve it up into many individual State grids with many and differing State transmission rules.

As discussed above, Congress intended to leave States with their existing retail ratemaking role. However, Congress also intended to create a vibrant wholesale transmission market by removing the previous monopoly utility control of the grid which excluded willing wholesale buyers and sellers of electric generation capacity.

The assertion by a State of a right to carve out and control transmission facilities connected to the interstate grid for the benefit of certain of its citizens is inimical to law, public policy and Congressional intent. New York's position is thus inconsistent with the Interstate Commerce Clause, the Federal Power Act and the Energy Policy Act of 1992.

On the other hand, the assertion of Enron Power Marketing, Inc. (Enron) in its brief that FERC should be compelled to extend its Open Access Transmission Tariff requirements to open up bundled retail sales to FERC jurisdiction is not supported by the record below, and is contrary to the intent of Congress that traditional State rate regulation of bundled electric service be permitted to continue. Should FERC conclude that a particular State statute or rule has exceeded state jurisdictional bounds by burdening interstate commerce or by creating undue discrimination against other wholesale customers dependent on the interstate grid, FERC has ample power to remedy such burden by order or rule.

CONCLUSION

The judgment of the Court of Appeals for the District of Columbia should be affirmed.

Respectfully submitted,

BOHDAN R. PANKIW
Chief Counsel
KAREN O. MOURY
Deputy Chief Counsel
JOHN A. LEVIN *
Assistant Counsel
PENNSYLVANIA PUBLIC UTILITY COMMISSION
Post Office Box 3265
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17105-3265
(717) 787-5978

* Counsel of Record

Counsel for Amicus Curiae the Pennsylvania Public Utility Commission